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Possibilities for Cross-Border Asset-Based Lending in Mexico

*David W. Banowsky**

I. Introduction — The Current Credit Environment in Mexico.

With the entry into force of the North American Free Trade Agreement (NAFTA)¹ and the Mexican Foreign Investment Law,² foreign lenders attempting to enter the Mexican financial services sector have been faced with certain provisions of Mexican law governing commercial credit transactions that contribute to lower lending volumes than many of these foreign financial institutions are accustomed to. By way of example, most "middle market" companies (primarily medium sized manufacturers that do not have access to capital markets and are currently not being served by commercial banks) cannot obtain credit in Mexico as readily as they might in the United States of America and Canada, the countries where many of these lenders are based. Very often, the primary assets of such middle market companies are their inventories of goods, and the accounts receivable that arise as a result of the sale of such inventory. Many of these companies may also be start up companies, companies that are in a growth mode or, increasingly, companies with some financial trouble. As a result, they cannot receive credit based solely on the strength of their balance sheet and cash flows.

In addition, such companies may not own the real estate on which they produce their products and cannot, therefore, secure the repayment of loans by a mortgage on real estate. As a result, if such companies are unable to pledge their personal property assets in order to obtain credit, credit will simply not be available to them; existing companies may be prohibited from expanding and modernizing their facilities; companies that are facing financial difficulties may find that they no longer have the sources of credit available to allow for a successful restructure; and there will be obstacles to the founding of new business.

The impact of this on the economy can mean fewer participants in a particular sector of the economy, less competition and, as a result, greater inefficiencies and greater prices. It

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1. a) The basic reference to NAFTA is North American Free Trade Agreement, December 17, 1992, U.S.-Can.-Mex., available in WESTLAW, NAFTA file [NAFTA]. b) See also H.R. Doc. No. 103-159, 103d Cong. 1st Sess., Vol. 1 at 609 (1993) (implements NAFTA message from the President of the United States and versions of NAFTA Supplements. c) North American Free Trade Agreement, drafted August 12, 1992, revised September 6, 1991, U.S. - Can. - Mex., 32 I.L.M. 605 (entered into force January 1, 1994) [*hereinafter* NAFTA].
 2. LEY DE INVERSIONES EXTRANJERAS [Foreign Investment Law], D.O. (Dec. 27, 1993).
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also impacts on the ability of domestic companies to compete with foreign producers of like goods and services.

As a result of NAFTA, Mexican companies are facing and will continue to face ever increasing direct competition from companies located in Canada and the United States of America. Canadian and U.S. firms that are similarly situated and of like size will, however, have a marked competitive advantage over Mexican companies in that, under their respective commercial laws, they will be able to more readily obtain credit.

Generally speaking, the law of non-possessory security interests is not as developed in Latin America as in the United States.³ While a few Latin American countries whose civil or commercial codes were they were enacted during the second half of the 20th century allow a debtor to use and enjoy personal property given in pledge, in most, such as Mexico, non-possessory security interests in personal property are governed by special statutes of narrow scope, enacted long after the respective civil and commercial codes of such countries came into effect.⁴ The "scope of application and flexibility" of such laws is closely related to the time period in which they were enacted, with the more liberal laws being the most recent.⁵ And, while many lenders use these special statutes to take non-possessory pledges of the goods covered by such statutes, it is nonetheless unusual for lenders to advance funds based on anything other than the value of the borrower's or a third party guarantor's real estate.⁶ Such limitations, both legal and those artificially imposed by existing lending practices, not only limit the availability of credit to those companies that do not own sufficient real property to mortgage, but also limit the amount of credit available to all borrowers, and the ability to restructure troubled loans individually or entire portfolios of troubled loans held by financial institutions.

As a result of both existing law and lending practice, the current commercial credit environment in Mexico is characterized by the following:

- Licensed financial institutions, especially certain of the Auxiliary Credit Organizations, play an important role in existing commercial lending in Mexico.
- It is important to understand the role these institutions play in the Mexican financial services sector in that certain activities, such as financial leasing, warehousing and factoring, may only be conducted on a regular basis with the prior authorization of the Ministry of Finance and Public Credit.⁷ In addition, Mexican law provides regulated financial institutions certain rights and benefits as creditors not otherwise available to creditors generally, including certain extra-judicial remedies.⁸
- Mexican borrowers are currently faced with high interest rates and the unavailability of credit.

3. Alejandro M. Garro, *Security Interests in Personal Property in Latin America: A Comparison with Article 9 and a Model for Reform*, 9 Hous. J. Int'l L. 157, 158 (1987).

4. *Id.* at 159-60.

5. *Id.* at 176.

6. Remarks of Panelists, Commercial Relations: Secured Transactions and Registry Systems Conference, in Hermosillo, Sonora, Mexico (Mar. 17, 1995).

7. See generally, LEY GENERAL DE ORGANIZACIONES Y ACTIVIDADES AUXILIARES DE CRÉDITO [General Law of Auxiliary Credit Organizations and Activities] [*hereinafter* L.G.O.A.A.C.].

8. See, e.g., L.G.O.A.A.C., *supra* note 7, arts. 46, 50.

- Existing laws and lending practices favor the guaranty of most loans by a mortgage over real property or by the personal guaranty of individuals who own real property.
- The reasons for the strong reliance on real property as a guaranty for the repayment of loans may be due more to legal limitations with respect to the pledge of personal property and current banking practices,⁹ than to economic factors.
- The risks associated with granting credit guaranteed by personal rather than real property are increased by the existing legal procedures for repossessing and realizing on personal property. Such procedures are so time consuming that the economic life of pledged goods may have passed by the time the lender can realize on such property.
- The existing legal framework for "perfecting" a pledge over personal property requires the dispossession of the borrower pledging such property in many cases, or may otherwise prove impractical with respect to certain types of property such as accounts receivable and contractual rights.¹⁰ As a result, it is difficult to make loans guaranteed solely by the personal property of a borrower.
- The legal preference for guarantying loans with real property means that only those companies that own real property or have a strong balance sheet or cash flows will have access to credit, and those lenders that are willing to lend money based solely on the value of the personal property assets of a company will find it harder to establish a niche in the financial services sector of the economy in order to provide credit to such companies.
- The impact of the foregoing is the unintended discriminatory effect of existing law against those "middle market" Mexican companies that are unable to offer real property as security for a loan.

This article will attempt to (1) address the issues involved with taking various types of collateral (i.e., accounts, inventory and equipment); (2) suggest certain methods that lenders in cross-border transactions might employ for securing loans with Mexican collateral, not customarily or widely utilized in Mexico; and (3) describe in greater detail the types of security devices available in Mexico and the rights available to the creditor in whose favor such devices are used.

II. Securing Personal Property Collateral in Mexico

A. LEGAL ISSUES WITH RESPECT TO LOANS SECURED BY PERSONAL PROPERTY

1. Personal Property That Can Be Pledged

(a) *Accounts receivable and intangible rights.* Although Mexican law allows for the pledge of all personal property, both tangible and intangible, that is susceptible to

9. See, e.g., LOS ALMACENES GENERALES DE DEPOSITO, LOS CERTIFICADOS DE DEPOSITO Y LOS CREDITOS MERCANTILES PRENDARIOS EN MEXICO 12 (*Asociacion de Banqueros de Mexico Comité de Almacenes Generales de Depósito* 1968) (discusses the breakthrough of recent legislation allowing the *habilitacion de bodegas*, or field warehousing, and how important this service is bringing credit to companies; almost 30 years later, however, field warehousing is still under-utilized in Mexico).

10. See, e.g., LEY GENERAL DE TITULOS Y OPERACIONES DE CRÉDITO art. 334 [*hereinafter* L.G.T.O.C.].

alienation,¹¹ relative difficulties in perfecting the pledge of certain types of intangible property has the practical effect of placing limits on the types of property that may be pledged. Most notably, while the accounts receivable (which arguably are a manufacturer's most valuable asset) and certain rights of a borrower may be pledged, the pledge of such property cannot be easily constituted. By way of example, the pledge of accounts receivable that are not negotiable by endorsement may only be constituted by delivery to the creditor of the invoices or other documents representing the account, and notification of the underlying obligor.¹² Mexican law requires such notification be made either in a public writing executed before a notary public,¹³ or before two witnesses.¹⁴ Interestingly, licensed factoring companies are permitted to effect such notification by means of a stamp or legend on the face of the invoice or via certified mail or facsimile.¹⁵ This additional requirement for constituting the pledge over intangible rights (*bienes incorpóreos*) makes the pledge of accounts receivable impractical at the volume required for commercial credit transactions.

Existing law governing the industrial mortgage,¹⁶ the *crédito refaccionario*¹⁷ and the *crédito de habilitación o avío*¹⁸ permits the registration of a mortgage or pledge that is arguably guaranteed by, among other things, the accounts receivable of the company receiving the credit. The most flexible of these devices, the industrial mortgage, is, however, only available to Mexican financial institutions.

(b) "Floating liens" (*garantía flotante sobre bienes inmuebles*). Mexican pledge law allows for the substitution of fungible items of property that are given in pledge.¹⁹ In addition, the industrial mortgage allows for a true floating lien over all personal property subject to the industrial mortgage, without need of the borrower to obtain the consent of the creditor for dispositions of such goods in the ordinary course of business.²⁰ Existing pledge law also allows for a pledge that guaranties future indebtedness.²¹

2. "Perfection" (Enforcement Against Third Parties) of the Pledge.

With only a few exceptions, the only means in which a creditor may "perfect" or enforce its pledge over personal property against third parties, is by taking possession of the

11. 2 JOAQUÍN RODRÍGUEZ RODRÍGUEZ, CURSO DE DERECHO MERCANTIL, 263 (18th. ed. 1985).

12. L.G.T.O.C., *supra* note 10, art. 334, III.

13. CÓDIGO CIVIL PARA EL DISTRITO FEDERAL [Civil Code for the Federal District] art. 2036 [*hereinafter* C.C.D.F.] (an assignee of credit obligations that are not to order or to bearer, may only pursue its rights against the debtor after notice of the assignment is given to same either (i) judicially, (ii) before two witnesses, (iii) or through a notary public.

14. *Id.*; CÓDIGO DE COMERCIO art 390 [*hereinafter* Cod. Com.].

15. L.G.O.A.A.C., *supra* note 7, arts. 45-I, 45-K.

16. LEY DE INSTITUCIONES DE CRÉDITO [Law of Credit Institutions] art. 67 [*hereinafter* L.I.C.]; L.G.O.A.A.C., *supra* note 7, art. 50.

17. L.G.T.O.C., *supra* note 10, art. 324.

18. *Id.* art. 322.

19. *Id.* art. 335.

20. L.I.C., *supra* note 16, art. 67; L.G.O.A.A.C., *supra* note 7, art. 50.

21. C.C.D.F., *supra* note 13, art. 2870.

pledged property.²² This method of perfection is satisfactory if the property pledged consists of documents and instruments, but unsatisfactory for most other types of property. The obvious drawback to this type of arrangement is that the debtor is unable to deal with pledged property, such as inventories or equipment, in the ordinary course of its business.

The *crédito refaccionario* and the *crédito de habilitación o avío*²³ allow for the recordation of a pledge agreement covering personal property without dispossession of the pledgor, and retention of the goods by the debtor, and in the case of the *crédito de habilitación o avío*, may be constituted over fungible goods.²⁴ The industrial mortgage also allows the debtor to retain possession of personal property subject to the industrial mortgage, including such intangible property as accounts receivable, and has the potential for a broader application than the "security interest" adopted in the United States in that it covers not only personal property, but real property as well.²⁵

3. Enforcement.

With very few exceptions (such as banks,²⁶ general deposit warehouses and other regulated financial institutions,²⁷ and trusts²⁸), creditors that have taken a pledge of personal property are prohibited by law from enforcing the pledge without first obtaining judicial approval to do so. Commercial warehouses, bonding companies and other regulated financial institutions that have taken a pledge of personal property are, however, provided a rapid, extra-judicial means of selling such collateral following the default of a debtor. In making its credit analysis a creditor must, therefore, expect a lengthy and expensive judicial proceeding prior to realizing on the assets pledged to guaranty repayment of the loan.²⁹

B. ACCOUNTS RECEIVABLE.

Accounts receivable financing in Mexico has traditionally been carried out by factoring companies, which are considered financial institutions under, and are regulated by, Mexican banking legislation.³⁰ Securing a loan with the accounts receivable of a borrower can be accomplished either through the assignment of accounts receivable to the lender, or through a pledge of such accounts. The mechanics of perfecting both the pledge and assignment are similar. As previously noted, however, the law regulating factoring companies provides factoring companies certain means of perfection that are much more efficient than those procedures required to be carried out by lenders that are not factoring companies,

22. See e.g., L.G.T.O.C., *supra* note 10, art. 334.

23. *Id.* art. 334, VII.

24. *Id.* arts. 321, 322.

25. L.I.C., *supra* note 16, art. 67.

26. L.G.O.A.A.C., *supra* note 7, arts. 21, 22.

27. L.I.C., *supra* note 16, art. 69; L.G.O.A.A.C., *supra* note 8, art. 46.

28. L.I.C., *supra* note 16, art. 83.

29. See C.C.D.F., *supra* note 13, art. 2884 (the right to dispose of pledged goods extra-judicially requires the express agreement of the parties).

30. L.G.O.A.A.C., *supra* note 7, arts. 45-A - 45-T.

giving factoring companies a marked advantage in accounts receivable financing at volumes required for most commercial transactions.³¹

1. *The Pledge of Accounts Receivable.*

Accounts receivable may be pledged in Mexico, although perfecting the pledge requires the physical deliver of invoices and notification of the pledge to underlying account debtors.³² As previously mentioned, such notification must either be before two witnesses or with the services of a notary public or public broker, adding to the time and cost associated with the pledge.³³

2. *The Assignment of Accounts Receivable.*

An absolute assignment of accounts receivable may also be made.³⁴ The requirements with respect to notification of account debtors will also be applicable for the assignment of accounts.³⁵ One benefit of using the assignment structure is that assigned property will usually be deemed to have been removed from the estate of the assignor in the event of the assignor's insolvency. Care must be taken, however, in structuring a revolving credit arrangement, to structure the transaction so as to avoid the argument that the assignment is in total satisfaction of the underlying debt.

3. *Use of a Factoring Company as a Servicer for the Pledge or Assignment of Accounts Receivable.*

It is possible for a creditor to contract with and to appoint a licensed factoring company as the servicer of accounts receivable given in pledge to such creditor.³⁶ As mentioned above, as regulated financial institutions, Mexican factoring companies have certain benefits with respect to the notification requirement; such as the authority to make such notification through a stamp or legend on the invoice, or via facsimile or certified mail.³⁷ In addi-

31. *Id.* art. 45-K. For example, while notice of the assignment of rights to collection in favor of a creditor must be given to the underlying account debtor in order to perfect such assignment, the factoring company may make such notification via one of the following alternatives:

I. By means of a legend or stamp on the subject invoices accompanied by evidence of receipt of same by the account debtor.

II. By certified mail, return receipt requested, or by telex or facsimile accompanied by evidence of receipt by the account debtor.

III. By use of a notary public, a public broker or other qualified public official.

Note that the only method available to lenders other than factoring companies is generally considered to be notification before two witnesses or a notary public. *Cf.* Cod. Com. art. 390.

32. L.G.T.O.C., *supra* note 10, art. 334, III.

33. Cod. Com., *supra* note 14, art. 390; C.C.D.F., *supra* note 13, art. 2033.

34. Cod. Com., *supra* note 14, arts. 389-91.

35. *Id.* art. 390.

36. See L.G.O.A.A.C., *supra* note 7, art. 45-A, VIII (one of the permitted activities for Mexican factoring companies, in addition to the factoring of accounts for their own benefit, is providing credit administration and collection services).

37. *Id.* art. 45-K.

tion, factoring companies are authorized by law to delegate the day-to-day servicing of accounts receivable to the party (such as a borrower) originating such accounts receivable, facilitating such transactions.³⁸ Such an arrangement will, however, add to the total transaction costs by as much as 1-2% of the face value of the accounts serviced by the factoring company.

C. INVENTORY.

In Mexico, a lien on inventory is created in the form of a pledge. The structure of the transaction will require that the pledge be perfected in one of three ways; either: (i) through delivery of the pledged goods to the creditor; (ii) by registration of the *crédito de habilitación o avío*; or (iii) by the delivery of the pledged goods to a third party.

1. Financing Credits (*Crédito de Habilitación o Avío*).

The *crédito de habilitación o avío* is a purpose credit that must be used for the acquisition of raw materials or inventory, and for the payment of wages, salaries, and other direct expenses required for the operation of a business.³⁹ This type of credit must be registered with the Public Registry of Commerce in order to perfect the pledge of the goods it covers and, therefore, has a distinct advantage over the typical commercial pledge, in that it permits the debtor to retain possession of the pledged goods.⁴⁰ Mexican law considers the pledgor under the *crédito de habilitación o avío* to be the judicially appointed bailee of such goods, with corresponding civil and criminal responsibility for dealing with goods subject to the *crédito de habilitación o avío* out of trust.⁴¹

The *crédito de habilitación o avío*, as a purpose credit, will not, however, be applicable to all types of credit transactions. As a form of purchase money credit, it may only be used to acquire new inventory, and not to encumber a borrower's existing inventories. In fact, a creditor extending the *crédito de habilitación o avío* that negligently allows the borrower to use loan proceeds for purposes other than those permitted by law or the parties agreement risks the extinguishment of its lien.⁴²

The lien of the *crédito de habilitación o avío* attaches automatically to not only the inventories purchased by the borrower with the proceeds of the credit, but also the fruits and products thereof.⁴³ This provision of the law could, under proper circumstances, be used to take finished goods inventory and accounts receivable as collateral, in addition to the materials purchased with the credit. In addition, when the pledged goods are of a fungible nature, the pledge over such goods will attach to any goods of the same specie substituted for such goods.⁴⁴ As such, with proper monitoring, the *crédito de habilitación o avío* could be used to secure a form of a revolving line of credit.

38. Reglas Básicas para la Operación de Empresas de Factoraje Financiero, art. Decimotercera Trece.

39. L.G.T.O.C., *supra* note 10, art. 322.

40. *Id.* art. 326.

41. *Id.* art. 329.

42. *Id.* art. 327.

43. *Id.* art. 322.

44. *Id.* art. 335.

2. Warehoused Inventory Financing in Mexico.

With warehouse financing, pledged goods are deposited with a licensed warehouse, thereby perfecting such pledge, which in turn issues warehouse receipts representing the goods deposited with the warehouse.⁴⁵ Such warehouse receipts may either be (i) non-negotiable deposit certificates, or (ii) negotiable deposit certificates, in which case one or more pledge bonds (*bonos de prenda*) are also issued in the name of, and delivered to, the creditor.⁴⁶ Goods cannot be removed by the borrower from the warehouse without presentation of the deposit certificate and, if applicable, also either presenting pledge bonds, or paying the outstanding balance of the loan granted in connection therewith.

Pledge bonds represent the pledge of the actual goods deposited with the warehouse, and upon default, the holder of the pledge bonds may order the warehouse to sell such goods.⁴⁷ As a regulated financial intermediary, federally licensed warehouses may conduct such sales extra-judicially by means of a public auction;⁴⁸ one of the only situations under Mexican law where a creditor may order the extra-judicial sale of pledged goods. The warehouse must give the borrower ten day's notice of its intention to sell goods at auction, and then must publish the notice of sale for an additional eight days.⁴⁹ Such sales are not uncommon in the warehouse industry, and can be completed in a relatively short period of time. In addition, in the event of the bankruptcy of the borrower, goods deposited with a warehouse for which pledge bonds have been issued, may be separated from the estate of the borrower.⁵⁰ The main drawbacks of warehouse financing are that it requires (1) the use of a federal licensed warehouse, which increases the cost, and (2) the dispossession of the borrower. Field warehousing by licensed warehouses is also allowed by statute in Mexico,⁵¹ permitting the perfection of the pledge by delivery of pledged goods to the warehouse on the premises of the borrower, limiting to a great extent the inconveniences arising from dispossession.

D. EQUIPMENT AND OPERATING CREDITS (CRÉDITO REFACCIONARIO).

The *crédito refaccionario* is a device expressly created by the *Ley General de Títulos y Operaciones de Crédito* for the perfection of a pledge of equipment by registration.⁵² Its use is limited, however, to purchase money obligations for the acquisition of equipment and for securing debts (or refinancing debts) that are less than 1 year old.⁵³

45. L.G.O.A.A.C., *supra* note 7, art. 11.

46. *Id.*

47. *Id.* art. 21; see also L.G.T.O.C., *supra* note 10, art. 239.

48. *Id.* arts. 21, 22.

49. *Id.* art. 21.

50. LEY DE QUIEBRAS Y SUSPENSIÓN DE PAGOS [Law of Bankruptcy and Suspension of Payments] art. 159, VI, d. [hereinafter L.Q.S.P.]

51. L.G.O.A.A.C., *supra* note 7, arts. 16, 16-A and 17.

52. L.G.T.O.C., *supra* note 10, art. 323.

53. *Id.*

E. REAL ESTATE

The mortgage is the traditional method for securing loans for the acquisition of residential real estate in Mexico (although the guaranty trust, discussed in greater detail below, is growing in popularity as a means to secure an obligation with real estate). Except for property of a nominal value, the mortgage must appear in a public instrument, and it must be registered in the corresponding Public Registry of Property in order to be effective against third parties. Foreclosure is effected by summary court proceedings.

III. The Basics of Mexican Security Devices

A. CONTRACTING GENERALLY

1. The Mexican Legal System

Mexico is a federal republic composed of thirty-one states and a federal district (Mexico City).⁵⁴ Each state has its own constitution, civil and criminal codes.⁵⁵ Federal laws with republic-wide application include the Code of Commerce and the General Law of Negotiable Instruments and Credit Transactions.⁵⁶

Mexico's legal system has its roots in the civil-law systems of Spain and France.⁵⁷ As a civil-law system, the Mexican legal system differs fundamentally from the common-law system of the United States in that while the common-law system is characterized by unwritten principles, often contradictory court opinions and powers vested in a judiciary allowing judges considerable liberty in interpreting precedent, under the Mexican civil-law system, laws are codified in a complete and carefully organized order.⁵⁸ Civil system codes have the benefit of certainty in that they are self-explanatory and require no outside interpretive guidance or authority.⁵⁹ A trade-off for such certainty, however, is a loss of flexibility often found in the common-law system.⁶⁰

In addition to the civil-law/common-law distinction between the U.S. and Mexican legal systems, the Mexican legal system also recognizes two fundamental divisions of the law.⁶¹ First, public law is categorized separately from private law, with public law including commercial law, constitutional law and criminal law, as well as civil and commercial procedural law; and private law including aspects of both commercial and civil law.⁶² Second, Mexican law makes clear distinctions between commercial law and civil law.⁶³ The Mexican

54. Sánchez-Mejorada, *The Commercial Laws of Mexico*, M 5 DIG. OF COM. LAWS OF THE WORLD 1 (Lester Nelson ed., 1992).

55. *Id.*

56. *Id.*

57. Rona R. Mears, *Contracting in Mexico*, 24 ST. MARY'S L.J. 737, 740 (1993) (citing 1 G. GREGORY LETTERMAN, *LETTERMAN'S LAW OF PRIVATE INTERNATIONAL BUSINESS* 79 (1990)).

58. *Id.* at 740-41.

59. *Id.* at 741-42.

60. *Id.*

61. *Id.*

62. *Id.* at 741-42.

63. *Id.* at 742.

civil law system includes family law, property law, contract law, and the law of succession; while Mexican commercial law includes corporate law, banking law, negotiable instruments law, bankruptcy, maritime, and insurance law.⁶⁴ Mexican law, as it relates to contracting and secured transactions, is built upon this dual statutory framework.⁶⁵ Determining whether the subject matter of a particular contract is civil or commercial in nature will determine the particular codes that govern such contract, the manner of enforcing the contract, and with respect to the pledge of personal property, will determine the manner of perfecting the pledge.⁶⁶ Likewise, determining whether a controlling document is a "public" or a "private" document will determine the manner in which lawsuits to enforce an underlying contract are tried, and the application of available procedural rules and remedies.

2. Public Documents

Pursuant to the *Código de Comercio* (the Code of Commerce), "public documents" are those that either receive the status of a public document as a matter of law or those commercial contracts entered into before a notary public and in accordance with the formalities required by law.⁶⁷ Public documents include "those granted by public authorities or public officers within the scope of their official capacity, or granted in proper legal manner by persons vested with public faith within the scope of their official capacity."⁶⁸

The execution of documents before a notary public is accomplished with numerous formalities, including: (1) signatures by all parties and the notary public on each page of the document, (2) the official seal of the notary public, and (3) a statement of detailed information concerning the parties.⁶⁹ In addition to the foregoing, when formalizing a contract in Mexico, agents must prove their authority to act in a representative capacity, foreign language documents must be translated into Spanish, and a translator must be provided for non-Spanish speaking parties.⁷⁰ The type of contracts which must be formalized before a notary public include corporate charter documents, deeds and contracts, such as mortgages, that transfer or create rights in real property, and powers of attorney.⁷¹

The Code of Commerce provides that the procedural rules contained in the Code of Commerce shall be supplemented by the Rules of Civil Procedure of the state in which a matter is being heard,⁷² and as such, the types of documents that are actually considered public documents may vary slightly depending on the rules contained in the specific codes of each state. Public documents are considered *prima facie* evidence of the existence or

64. *Id.* at 742.

65. Manuel G. Barragán, *Highlights of Mexican Law Concerning Contractual and Procedural Formalities*, in 1 *DOING BUSINESS IN MEXICO* pt. III, § 106[1] (Michael W. Gordon ed., 1992); Mears, *supra* note 57, at 742.

66. Barragán, *supra* note 65, pt. III, §106[1].

67. *Cod. Com.*, *supra* note 14, art. 1237.

68. RAFAEL DE PIÑA & JOSÉ CASTILLO LARRAÑAGA, *INSTITUCIONES DE DERECHO PROCESAL CIVIL*, Mexico, 319 (14th ed. 1981) (revised, supplemented, and updated by Rafael De Piña Vara).

69. Mears, *supra* note 57, at 750.

70. *Id.* at 751.

71. *Id.*

72. *Cod. Com.*, *supra* note 14, art. 1054.

nonexistence of certain facts or acts referred to therein,⁷³ and in some cases, also provide the basis for executive judicial proceedings.⁷⁴

3. Private Documents

Private documents are, by exclusion, all documents not considered public documents.⁷⁵ Unlike public documents, private documents may only be used as the foundation of an executive judicial proceeding if acknowledged by the defendant.⁷⁶ Private documents cannot be transformed into public documents simply by their filing in public records and certification by a public officer. Such certification as a public instrument only proves the fact of registration of such document, and does not have probative value with respect to the contract of which it makes reference in that it was not executed before a notary public or a public officer, a necessary condition to its establishment as a public document.⁷⁷

B. THE MORTGAGE

1. The Real Estate Mortgage

In Mexico, the rights of individuals in real estate are governed by the Civil Code,⁷⁸ and the most widely used security device in Mexico is the mortgage on real estate (*hipoteca*).⁷⁹ The Civil Code defines a mortgage as a guaranty *in rem* constituted on property that is not delivered to the creditor, and giving the creditor the right, in case of default, to be paid with the value of such property, in the degree of preference established by law.⁸⁰ The one significant difference between the mortgage in the United States and Mexico is that, under Mexican law, certain items of personalty such as livestock, farm machinery, crops, and other agricultural items may be covered by the lien of a real estate mortgage.⁸¹ While a mortgage may only encumber identifiable property designated by the mortgagor, the lien of a mortgage extends by implication to:⁸²

- (1) the natural accessions of the mortgaged property;
- (2) the improvements made by the owner in the encumbered property;

73. CÓDIGO DE PROCEDIMIENTOS CIVILES PARA EL ESTADO DE NUEVO LEÓN [Code of Civil Procedure of the State of Nuevo Leon] art. 369. RAFAEL DE PIÑA & RAFAEL DE PIÑA VARA, DICCIONARIO DE DERECHO, 425 (18th ed. 1992) (updated by Juan Pablo De Piña Garcia).

74. Cod. Com., *supra* note 14, art. 1391, II.

75. Cod. Com., *supra* note 14, art. 1238.

76. Cod. Com., *supra* note 14, art. 1391, VII.

77. Volume LIII Fifth Epoch, pt. 1, at 358 (1936).

78. Alejandro Delgado F., *Foreign Investment in Mexican Real Estate*, in 3rd Annual Expanding Abroad Conference: Planning for North American Free Trade Papers 5 (1992) (on file with St Mary's Law Journal).

79. MODERN LEGAL SYSTEMS CYCLOPEDIA *Legal System of Mexico* § 1.4 (E), at 1.30.36 (1988).

80. C.C.D.F., *supra* note 13, art. 2893. While each of the Mexican states has its own Civil Code, most are based upon the Civil Code for the Federal District. As such, references to the Civil Code will be to the Civil Code for the Federal District.

81. *Id.*

82. *Id.* art. 2895.

- (3) the movable objects permanently incorporated with the estate by the owner that cannot be removed without damage to the property or destruction of such objects; and
- (4) improvements constructed by the owner on the mortgaged land and to additions to existing improvements.⁸³

Unless otherwise agreed, a mortgage will not encumber:

- (1) industrial fruits of the property mortgaged, provided such fruits were produced before the creditor demands the payment of its credit; and
- (2) rents due and unpaid at the time that demand is made for payment of the obligation secured by the mortgage.⁸⁴

The following cannot be mortgaged:

- (1) pending fruits and rents *apart from the estate that produces them*;
- (2) movable objects permanently placed in buildings, either for their embellishment or convenience, or for the service of any industry, *unless they are mortgaged together with such buildings*;
- (3) servitudes, *unless they are mortgaged together with the dominant tenement*;
- (4) the right to receive fruits under the usufruct⁸⁵ granted by the Civil Code to ascendants with respect to the property of their descendants;
- (5) the use and right of habitation; and
- (6) property in litigation, unless a record of the complaint which gave rise to the suit has been recorded and the mortgagee declares in the mortgage that it has knowledge of the litigation; but in any case the mortgage remains subject to a final order with respect to such litigation.⁸⁶

Mexican law defines personalty or movables as all property not considered by law as realty, or immovables.⁸⁷ Article 750 of the Civil Code enumerates those items, in addition to what might otherwise be considered personalty, that are considered realty and thus, may be subject to the mortgage. The following is a non-exhaustive list of items considered real property that may be encumbered by a mortgage on real estate: (1) plants and trees and the pending fruits of such plants and trees; (2) statues, reliefs, paintings, and other objects of ornamentation intended to be united permanently to the realty; (3) fertilizer and seeds intended for cultivation on the estate; (4) dovecotes, beehives, fishponds, and other breeding places preserved by the owner with the intent that they form a part of the realty; (5) electrical apparatus and accessories attached to the soil or buildings (unless specifically reserved); (6) certain riparian rights as well as aqueducts and pipelines of any kind that

83. *Id.* art. 2896.

84. *Id.* art. 2897.

85. "A usufruct which may be created by contract or by operation of law, is a temporary right *in rem* to the use of and fruits of the property." MODERN LEGAL SYSTEMS CYCLOPEDIA, *supra* note 79, at 1.3036.

86. C.C.D.F., *supra* note 13, art. 2898.

87. *Id.* art. 759; John Gerber, *Secured Credit Devices in Latin America: A comparison of Argentina, Brazil and Mexico*, 23 U. MIAMI L. REV., at .677, 683 (1969).

serve to conduct or extract liquids or gases to or from the property; (7) breeding stock maintained on rural estates; (8) machines, equipment, instruments, or utensils used in the exploitation of the enterprise conducted on the estate; and (9) the rolling stock of railroads, telephone and telegraph lines, and fixed radio-telegraph stations.⁸⁸

Any transfer or sale of real property with more than a nominal value (as set forth in the applicable civil code), including the mortgage of real property guaranteeing an obligation exceeding such an amount, must be made in writing and formalized before a notary public in order to be valid.⁸⁹ A mortgage must be recorded in the public register of property to be effective against third parties.⁹⁰ The lien of a properly recorded real estate mortgage takes priority over all other liens with the exception of a lien for unpaid taxes, past due wages, and liens perfected prior in time.⁹¹ A mortgage may subsist as long as the principal obligation.⁹² When no expiration date is indicated, however, the mortgage is only effective for ten years.⁹³ A mortgage term may be extended one time, and the preference of the mortgage shall, during the period of the extension, relate back to its origin.⁹⁴ During any subsequent extensions, the mortgage shall have preference only as of the date of registration of the last extension.⁹⁵ The action to foreclose must be commenced within ten years after the cause accrues.⁹⁶

In case of default under the mortgage, the mortgagee has the right to foreclose and enforce the sale of the mortgaged property through public auction, by initiating a specific judicial proceeding (*juicio especial hipotecario*). Once the sale of the mortgaged assets takes place, the mortgagee has access to the proceeds of such sale. The mortgagee may also bid at such auction to acquire ownership of the mortgaged property. In addition, if the mortgaged property becomes insufficient to secure the principal obligation, the mortgagee may demand that the difference be paid, and if not paid, bring an action to attach additional assets of the borrower.⁹⁷

Upon the filing of a petition for foreclosure, the court publishes the foreclosure petition and records the same in its registry. Any lienholder of record will be notified of the proceeding so that it may present its claims. The debtor then has nine days in which to reply, and if it fails to reply, the court may order the sale of the property at public auction.⁹⁸ If the

88. C.C.D.F., *supra* note 13, art. 750.

89. LAW OF THE NOTARY, art. 54; *See also* Delgado, *supra* note 78, at 17.

90. *Id.*; *see also* A. Beardeha-Prieto, *Debt Collateralization and Business Insolvency: A Review of the Mexican Legal System*, in THIRD NATIONAL INSTITUTE ON MULTINATIONAL COMMERCIAL INSOLVENCY, A.B.A. DIVISION FOR PROFESSIONAL EDUCATION 0-3 [*hereinafter* MULTINATIONAL COMMERCIAL INSOLVENCY].

91. MODERN LEGAL SYSTEMS CYCLOPEDIA, *supra* note 79, at 1.30.37.

92. Gerber, *supra* note 87, at 700.

93. C.C.D.F., *supra* note 13, art. 2927.

94. *Id.* art. 2929.

95. *Id.* art. 2930.

96. *Id.* art. 2918.

97. *Id.* art. 2907.

98. C.P.C., *infra* note 259, art. 470; *See also* MODERN LEGAL SYSTEMS CYCLOPEDIA, *supra* note 79, at 1.30.37; MULTINATIONAL COMMERCIAL INSOLVENCY, *supra* note 90, at 0-4; Gerber, *supra* note 87, at 700.

borrower replies to the petition, each party will then have an additional 10 day period to submit evidence. The court then commences to rule on the evidence, a period that generally takes up to 3 months. After all evidence is ruled upon, the court will render its judgment. In judicial foreclosure proceedings it can take up to one and one-half years to obtain a final judgement and an order to sell the mortgaged property.

Once a final judgement is rendered, a public auction of the property is ordered through the court in which the judge presiding over the trial sits. The property will be valued by an official appraiser prior to auction, and such appraisal will be the basis for the minimum bid price.⁹⁹ The auction will be announced by the publication of notices in a newspaper distributed in the jurisdiction of the court. Before the auction begins, the debtor has the right to redeem the property by paying the outstanding principal amount of the debt and any unpaid interest thereon, and by making a deposit guaranteeing the cost of the auction.

Initial bids must be in an amount equal to at least two-thirds of the value of the property.¹⁰⁰ The judge will read out the bids received and invite higher bids. If no new bids are made, the sale will be announced and the judge will order the transfer of the property to the successful bidder. If no bidders appear at the first auction, the mortgagee may request the judge to either award the property to the creditor for an amount equal to two-thirds of the appraised value, or to order a second auction in which the starting price will be twenty percent lower than the previous minimum bid price.¹⁰¹

Upon the sale of the property, the new owner will receive the necessary documentation evidencing title from the court (or the mortgagor) and the court will have the property delivered to same (unless there are third parties with legitimate rights to the use of the property, such as lessees pursuant to current valid lease agreements). In the event a deficiency remains, the creditor may seek a judgment ordering payment of same via normal judicial procedures.

2. The Chattel Mortgage

The predecessor to the current Civil Code limited the mortgage to immovable property.¹⁰² The current version of the Civil Code, however, has no such limitation, "thus implying that chattels are also susceptible to being mortgaged so long as they are specifically identifiable."¹⁰³ As a result, a debate has arisen concerning the existence of a chattel mortgage under Mexican law.¹⁰⁴ One commentator has stated that it is perhaps "the result of some unfortunate foreign insistence on universal recognition of chattel mortgages that Mexican legal materials occasionally include positive declarations that 'movable properties may be

99. C.P.C., *infra* note 259, art 485.

100. C.P.C., *infra* note 259, art. 573. See also MODERN LEGAL SYSTEMS CYCLOPEDIA, *supra* note 79, at 1.30.37; MULTINATIONAL COMMERCIAL INSOLVENCY, *supra* note 90, at 0-4.

101. C.P.C., *infra*, note 259, art. 582; MODERN LEGAL SYSTEMS CYCLOPEDIA, *supra* note 79, at 1.30.37.

102. Gerber, *supra* note 87, at 699.

103. *Id.*

104. See James E. Ritch, *Legal Aspects of Lending to Mexican Borrowers*, 7 N.C. J. INT'L L. & COM. REG. 315, 328 (1982) (chattel mortgage exists in Mexico only with respect to ships and aircraft); Garro, *supra* note 3, at 185-86 (chattel mortgage exists, but is impractical).

mortgaged”¹⁰⁵ Notwithstanding the foregoing, technically, Mexican law appears to recognize a chattel mortgage, which is not unlike the civil pledge (discussed below), with the following exceptions: (1) as discussed above, the mortgage may not encumber certain personality specifically excluded by statute;¹⁰⁶ and (2) whereas, depending on the type of transaction involved, a pledge may be governed by either the civil law or the commercial law, the mortgage, even though securing a commercial obligation, will always be governed by the Civil Code.¹⁰⁷ As such, the cumbersome formalities and controls placed upon the mortgage device appear to make the chattel mortgage less favored in Mexico than the pledge as a security device over personality, and in addition, the mortgage, as opposed to the pledge, generally will not attach to the proceeds of collateral.¹⁰⁸

C. THE GUARANTY TRUST

Trusts (*fideicomisos*) are widely used in Mexico for many different purposes and in a wide variety of transactions. Trusts are regulated in the Negotiable Instruments Law and the Law of Credit Institutions, and are considered commercial acts. Trust laws in Mexico are comparatively modern and generally provide ample protection for the beneficiary, and where the security involves a substantial amount of property, a trust arrangement may well be the best solution for the secured creditor.¹⁰⁹ Pursuant to Mexican law, only legally designated Mexican banks may serve as trustees.¹¹⁰ The recently enacted Foreign Investment Law permits a trust to have a maximum duration of fifty years.¹¹¹

A trust is established by an agreement between the settlor or settlors and the trustee, by virtue of which the settlors contribute certain assets for the accomplishment by the trustee of the purposes of the trust. The trust arrangement may be used for various purposes, such as to secure the fulfillment of an obligation (“guaranty trust”), to manage assets (“management or administration trust”), to transfer property (“transfer of title trust”), to invest in shares and other securities (“investment trust”) and to create a business concern (“business trust”).¹¹²

105. John F. Bass, Jr., *Secured Interests in Movable Property in Mexico*, 4 TEX. INT’L L.F. 96, 102 (1968) (now TEX. INT’L L.J.).

106. C.C.D.F., *supra* note 13, art. 2898.

107. 2 JOAQUÍN RODRÍGUEZ RODRÍGUEZ, *CURSO DE DERECHO MERCANTIL* 242 (20th ed. 1991).

108. Garro, *supra* note 3, at 186 n.135; Gerber *supra* note 87, at 698.

109. Bass, *supra* note 105, at 105. The rights and powers of a trust beneficiary under Mexican law are:

1. Those granted to him by the trust instrument.

2. To enforce fulfillment by the trust institution.

110. L.G.T.O.C., *supra* note 10, art 350; JOSEPH WHELESS, *COMPENDIUM OF THE LAWS OF MEXICO* (2d ed. 1938); Gerber, *supra* note 87, at 709; Bass, *supra* note 105, at 105.

111. See Foreign Investment Law, *supra* note 2, art.13. See also L.G.T.O.C. *supra* note 10, art. 353; WHELESS, *supra* note 110, arts. 985-992; C.C.D.F. *supra* note 13, arts. 1472-1482; Cod. Com. *supra* note 14, arts. 346-359.

112. Carlos Creel C., *Securities Under Mexican Law; Doing Business in the new Texas-Mexico Market: A practical Guide to Transnational Transactions*, State Bar of Texas, Monterrey, Mexico (1995) (unpublished paper).

Property and rights of all kinds may be placed in trust.¹¹³ The trust may be constituted by a deed executed by a living person or by will, and must, in all cases, be in writing and conform to the requirements governing the transfer of rights in or ownership of the property given in trust.¹¹⁴ Trusts affecting real property must be recorded in the public registry where the property is situated, and take effect against third parties from the date of recordation in the public registry.¹¹⁵ A trust involving personal property will take effect against third parties from the date the following requisites are complied with:

- (1) in the case of a non-negotiable credit instruments or personal rights, from the moment the obligor is notified of the trust;
- (2) in the case of nominative instruments, from the date of endorsement of the instrument to the trustee and the recordation of such endorsement in the register of the issuer, if applicable; and
- (3) in the case of tangible property or bearer instruments, from the moment of possession of same by the trustee.¹¹⁶

The guaranty trust has proved to be an effective mechanism for creating a security interest under Mexican law, and, in many cases, it is preferred by creditors over such devices as the mortgage and the pledge.¹¹⁷ Once a settlor has contributed assets to a trust, such property will be held by the trustee and will form an *isolated* and *separate* estate, independent from the assets of the settlor or the trustee.¹¹⁸ The trust estate will not, therefore, be included in the bankruptcy of either the settlor or the trustee.¹¹⁹ Likewise, the creditors of the settlor or the trustee may not attach or otherwise create a lien on any of the assets of the trust.¹²⁰

A trust is extinguished by either: (i) the accomplishment of its purposes, (ii) the impossibility of fulfillment of its purposes, (iii) the exercise by the settlors of their right to revoke the trust, if applicable, (iv) the mutual agreement of the settlors and the beneficiaries, and (v) the removal or resignation of the trustee, without designation of a substitute.¹²¹ A trustee may only resign, however, with prior judicial authorization, which authorization will only be given if properly justified.¹²² Trusts can be revocable or irrevocable, and if a trust is irrevocable the settlors may not modify its terms without the prior consent of the beneficiaries.¹²³

With the guaranty trust, foreclosure may be achieved extrajudicially by incorporating a conventional mechanism in the trust agreement, or judicially by following the procedure

113. L.G.T.O.C., *supra* note 10, art 351.

114. L.G.T.O.C., *supra* note 10, art. 352.

115. L.G.T.O.C., *supra* note 10, art. 353; WHELESS, *supra* note 110, art. 989.

116. L.G.T.O.C., *supra* note 10, art. 354.

117. Creel, *supra* note 112.

118. *Id.*

119. *Id.*

120. *Id.*

121. *Id.*

122. *Id.*

123. *Id.*

applicable to commercial pledges established in the Negotiable Instruments Law. In the case of non-judicial foreclosure, upon the occurrence of an event of default, the lender (the primary beneficiary of the trust) will deliver a notice of default to the trustee, which, in turn, will deliver a notice of default to the borrower/settlor, and request that evidence of the cure of such default be presented within the specific time period established in the trust agreement. If the default is not cured within such time period, the trustee will give the borrower notice of its intention to foreclose upon the trust property within a specific time period (which may be as short as 5 days). If, at the end of this time period, the default is not cured, the trustee will dispose of the property as provided in the trust agreement.

D. PERSONAL PROPERTY

1. The Pledge (*prenda*)

Two types of pledges exist in Mexico: a "traditional" or civil pledge and the "mercantile" or commercial pledge.¹²⁴ The Civil Code provides the basic rules for governing both types of pledges, while the Code of Commerce and General Law of Instruments and Credit Operations (*Ley General de Títulos y Operaciones de Crédito*) (LGTOC) provide specific provisions with respect to the commercial pledge.¹²⁵ The rules governing the civil pledge will apply equally to the commercial pledge where the provisions of the LGTOC, the Code of Commerce, or other legislation are silent on a matter.¹²⁶

While the mercantile pledge is similar to the civil pledge in many respects, it is a security device that has been tailored to meet certain legal and practical needs of the commercial sector.¹²⁷ The civil pledge and the commercial pledge differ significantly in the types of transactions for which each is to be used, the method of perfection of each, and the method of realization on collateral pledged pursuant to each. The civil pledge allows for constructive delivery of pledged goods through recording the pledge, whereas the mercantile pledge, with a number of important exceptions, requires physical delivery of the pledged property to the creditor.¹²⁸ As such, it is important to determine which of the two types of pledges is appropriate for a particular transaction.

(a) *The Commercial Pledge* (*La Prenda Mercantil*). If the pledgor is a commercial enterprise or businessman, or if the subject matter of the pledge is commercial, it will be governed by the LGTOC rather than by the Civil Code. While the LGTOC sets forth the requirements for a pledge in "commercial transactions,"¹²⁹ the LGTOC does not otherwise indicate when a pledge is of the commercial or civil variety.¹³⁰ The Code of Commerce, however, enumerates those types of contracts and transactions which are considered "com-

124. John F. Munger, *Rights and Priorities of Secured Creditors of Personalty in Mexico*, 16 ARIZ. L. REV. 767, 782 (1974).

125. Garro, *supra* note 3, at 171.

126. *Id.*

127. Gerber, *supra* note 87, at 686-87.

128. José M. Abascal Z., *Consideraciones Acerca de la Posesión de los Bienes Inmuebles en la Prenda*, 40 BOLETÍN MEXICANO DE DERECHO COMPARADO 13, 26-29 (1981).

129. L.G.T.O.C., *supra* note 10, art. 334.

130. Munger, *supra* note 124, at 788.

mercial.”¹³¹ Therefore, any pledge guaranteeing one or more of the enumerated “acts of commerce,” as defined by article 75 of the Code of Commerce, would be a commercial pledge, subject to the provisions of the LGTOC.¹³² All other transactions would be considered civil and subject to the provisions of the Civil Code.¹³³

Article 334 of the LGTOC states that in commercial transactions, a pledge is constituted by:

- (1) delivery to the creditor of the goods or negotiable instruments, if the latter are to bearer;
- (2) by endorsement of negotiable instruments in favor of the creditor, in the case of nominative instruments, and by the same endorsement and the corresponding notation of same in the register for the instruments if they are of the type referred to in article 24 of the LGTOC;
- (3) delivery of the instrument or the document representing the credit to the creditor, in the case of non-negotiable instruments, such as accounts receivable, and by recording the lien in the register of the instrument, or by notification of the debtor (with respect to accounts receivable, the underlying account debtor), depending on whether it concerns instruments or credits that require this inscription;
- (4) the deposit of the goods or instruments, if the latter are to bearer, with a third party designated by the parties, and at the disposal of the creditor;
- (5) the deposit of the goods at the disposal of the creditor in places to which he has possession of the keys, even though such places are owned by or located within the establishment of the debtor;¹³⁴
- (6) the delivery or endorsement of the instrument representing the goods that are the object of the contract, or by the issue or endorsement of a pledge bond relative thereto;
- (7) the registration of the contract for the equipment or operating credit (discussed below) in the manner set forth in article 326 LGTOC; and
- (8) compliance with the requisites set forth in the General Law of Banking Institutions, insofar as they concern book credits.¹³⁵

Constructive delivery is generally not allowed in commercial pledges.¹³⁶ As such, with the exception of the type of credits described in article 326 of the LGTOC (discussed below), the pledgee of collateral subject to a commercial pledge should expect to take physical possession of the collateral.¹³⁷ Additionally, whenever applicable law or an instrument itself requires that an interest in an instrument be recorded in the register of the party who

131. Cod. Com., *supra* note 14, art. 75.

132. RODRIGUEZ, *supra* note 107, at 234; Barragán, *supra* note 65, pt. III, § 106(1); Mears, *supra* note 7, at 742.

133. Barragán, *supra* note 14, § 106(1); Mears, *supra* note 57, at 742; Gerber, *supra* note 87, at 687.

134. In this case, actual delivery of the locale in which the pledged goods are stored is deemed to take place. See R. CERVANTES AHUMADA, TÍTULOS Y OPERACIONES DE CRÉDITO 285 (11th ed. 1979). This type of arrangement would be similar to the pre-UCC field warehousing arrangement.

135. Abascal, *supra* note 128, at 35-36.

136. Garro, *supra* note 3, at 186, 121.

137. Abascal, *supra* note 128, at 29.

issues it, the pledge will not be effective against the issuer or third parties if the instrument is not also endorsed by the debtor (if to order) and so registered.¹³⁸ A pledge in fungible goods continues to be effective even when the original goods are substituted for goods of the same specie.¹³⁹

Although constructive delivery of pledged goods is generally not recognized for the commercial pledge, a number of instances occur when pledged goods may be placed with a third party,¹⁴⁰ or under the joint control of the debtor and the creditor,¹⁴¹ or left in the possession of a third party as a "*depositario judicial*" with perfection of the pledge accomplished not by possession but by registration in the mortgage registry in the case of a pledge of real property or in the registry of commerce in the case of a pledge of personalty.¹⁴²

(b) Warehousing

- (1) Licensed Commercial Warehouses. "The most typical and commonly used commercial pledge involves collateral in the form of documents of title such as a negotiable bill of lading or a negotiable warehouse receipt."¹⁴³ Secured financing on warehoused collateral is a traditional example of the perfection of a pledge in Mexico through constructive possession of collateral.¹⁴⁴ Articles 229-251, and 334 of the LGTOC provide for the pledge of goods deposited with bonded warehousemen operating in accordance with the Ley General de Instituciones de Crédito (General Law of Banking Institutions) and the Ley General de Organizaciones y Actividades Auxiliares del Crédito (Law of Auxiliary Credit Institutions). Bonded warehouses, like leasing companies, factoring companies, credit unions, savings and loan companies, and financial leasing companies, are regulated and licensed pursuant to the Law of Auxiliary Credit Institutions.¹⁴⁵ Under this system, a bonded warehouseman is required to issue both a deposit certificate (*certificado de depósito*) which verifies the ownership of the merchandise or goods deposited with the warehouseman, and a pledge bond (*bono de prenda*) as part of the warehouse receipt.¹⁴⁶ The depositor/pledgor may transfer its rights to the goods evidenced by the deposit certificate by endorsing or pledging the *bono de prenda* to a creditor.¹⁴⁷

According to Mexican law, a warehouse may only release warehoused goods to the holder of both the deposit certificate and the pledge bond.¹⁴⁸ As

138. L.G.T.O.C., *supra* note 10, arts. 334(II), (III).

139. *Id.* art. 335.

140. *Id.* art. 334(IV).

141. *Id.* art. 334(V).

142. *Id.* arts. 326, 334(VII).

143. Garro, *supra* note 3, at 226.

144. James D. Pendergast, *Cross-Border Lending Transactions*, SECURED LENDER, Jan./Feb. 1994, at 24; Garro, *supra* note 1, at 226.

145. L.G.O.A.A.C., *supra* note 7, art. 5.

146. L.G.T.O.C., *supra* note 10, art. 229; CERVANTES, *supra* note 134, at 158-62; *Mexican Warehouse Receipt Law*, *infra* note 150, 503 (1993). Each negotiable warehouse receipt must be issued with the *bono de prenda* attached. L.G.T.O.C. *supra* note 10, art. 230.

147. L.G.T.O.C., *supra* note 10, art. 230; Garro, *supra* note 3, at 226.

148. L.G.T.O.C., *supra* note 10, arts. 239-40; *Mexican Warehouse Receipt Law*, *infra* note 150, 506 (1993).

such, a person holding only a deposit certificate, while retaining dominion over the goods deposited with the warehouseman, may not remove such goods without paying not only all amounts due the warehouseman for storage, but also the amount covered by the respective pledge.¹⁴⁹ The holder of warehouse receipts will have rights in pledged goods superior to those of judgment creditors, and without a court order to the contrary, superior rights in the proceeds of such goods whether in the form of sale proceeds or insurance proceeds as a result of damage or destruction.¹⁵⁰

It has been suggested that a floating lien could be established on warehoused inventory through the use of the *bono de prenda*.¹⁵¹ In actual practice, however, the *bono de prenda* appears to have had little practical application in establishing a floating lien, in that Mexican banks, the creditors historically involved in warehouse financing, also have owned or operated the warehouses where pledge goods are stored and as such, have required the delivery of both the *bono de prenda* and the deposit certificate, thus rendering the function of the *bono de prenda* null.¹⁵² This may change in the future with the establishment by foreign non-banks such as U.S. finance companies of financial groups in Mexico that include a warehouse within the financial group.

- (2) The "Confidential Warehouse Receipt". Outside of the Law of Auxiliary Credit Institutions and the regulations promulgated thereunder governing the operation of federally licensed warehouses, the Mexican warehousing industry has, in response to the burdens of operating a federally licensed warehouse, created the confidential warehouse receipt (*el certificado confidencial de depósito*).¹⁵³ The confidential warehouse receipt is used extensively in the Mexican warehouse industry and is accepted as collateral by banks even though there is no statutory recognition of this type of warehouse receipt.¹⁵⁴ The confidential warehouse receipt consists of a personal note from the warehouseman, and when issued in connection with the pledge of goods delivered to the warehouse, is considered by many banks as collateral for commercial financing purposes.¹⁵⁵ The use of the confidential warehouse receipt allows for the financing of warehoused goods without the requirement of obtaining a federal warehouse license and the compliance with, among other

149. L.G.T.O.C., *supra* note 10, art. 240.

150. O'Malley & Olea, *A Comparison of U.S. and Mexican Warehouse Receipt Law and Practice*, in *TOWARD SEAMLESS BORDERS; MAKING FREE TRADE WORK IN THE AMERICAS*, 484, 506 (B. Kozolchuk ed., 1993) (citing the decision of Mexico's Supreme Court in *Almacenadora del Noroeste S.A.*, 10_ Seminario, 5ª época, p. 1188 (1949)).

151. See Garro, *supra* note 3, at 226.

152. CERVANTES, *supra* note 134, at 162; *Mexican Warehouse Receipt Law*, *supra* note 150, at 501; See also Pendergast, *supra* note 144, at 26 ("While inventory may be pledged under Mexican law, as a practical matter it is difficult (although not impossible) to create an enforceable pledge agreement in inventory under Mexican law. At present time, financing based on inventory security is unusual in Mexico.")

153. *Mexican Warehouse Receipt Law*, *supra* note 150, at 507.

154. *Id.*

155. *Id.* at 508.

things, very stringent minimum capital investment requirements.¹⁵⁶ Although not expressly recognized by a statute, the savings involved with the use of a confidential warehouse receipt over the warehouse receipt issued by a licensed warehouse appears to significantly outweigh the risks involved. Estimates are that at least half, if not more, of all products stored in warehouses in Mexico are stored under confidential warehouse receipts.¹⁵⁷

It appears possible that collateral management companies or companies with experience in monitoring collateral for asset based lending transactions, such as U.S. finance companies, could use this type of arrangement to perfect a pledge of inventory (by delivery to the lender or a third party) and finance loans secured by inventory. However, this arrangement does have at least two drawbacks when compared to use of a licensed warehouse. First, only licensed warehouses are permitted to issue both deposit certificates and pledge bonds, the latter which are considered to be negotiable instruments under Mexican law; and second, only licensed warehouses are permitted by law to foreclose on pledged goods non-judicially.¹⁵⁸

- (3) Field Warehousing. Mexican law also permits field warehousing, by which licensed warehouses are permitted to enter into accommodation leases with a borrower and establish the borrower's own premises as an approved facility from which the warehouse may operate.¹⁵⁹ The obvious advantage to this type of arrangement is that, although pledged goods are delivered to a third party (the warehouse) to perfect the pledge of such goods, pledged inventory does not have to be moved out of a borrower's facilities. It is likely that, due in part to the extra-judicial remedies associated with warehouse financing, this type of arrangement will become increasingly more popular as entities with experience in monitoring collateral levels on a regular basis and granting loans based on the value of personal property enter the Mexican financial services sector in increasing numbers.

(c) *Equipment and Operating Credits/Financing Credits* (Crédito Refaccionario y Crédito de Habilitación o Avío). The method of constituting the pledge guaranteeing repayment of these credits was provided by special legislation to finance the operational expenses and economic production of a business.¹⁶⁰ The *crédito de habilitación o avío* is a credit that must be used for the acquisition of raw materials or for the payment of wages, salaries, and other direct expenses required for the operation of the business.¹⁶¹ The *crédito refaccionario* must be used for the purchase or installation of machinery and in the construction or development of other projects required for the development of the business.¹⁶² These credits have the distinct advantage over most commercial pledges in that they permit the debtor

156. *Id.*

157. *Id.* (30% to 35% interest is common for warehouse receipt financing, as opposed to approximately 15% in the U.S.).

158. L.G.O.A.A.C., *supra* note 7, arts. 21, 22.

159. *Id.* arts. 16, 16-A and 17.

160. Garro, *supra* note 3, at 186-87.

161. L.G.T.O.C., *supra* note 10, art. 321.

162. Garro, *supra* note 3, at 186-187.

to retain possession of the collateral that secures the credit.¹⁶³ This form of credit has an advantage over a mortgage as well, in that it can encumber the real property on which a wide variety of personal property is located, and may be foreclosed pursuant to the summary proceedings provided in the Code of Commerce.¹⁶⁴ The *crédito refaccionario* and the *crédito de habilitación o avío* will not benefit every creditor, however, because they are primarily purchase money devices, designed to finance operational expenses and the purchase of raw materials and equipment for manufacture and production. The lien of the *crédito refaccionario* and *crédito de habilitación o avío* continue to attach to the borrower's finished products even though they originally were only secured by the equipment or raw materials used to produce such products.¹⁶⁵ The creditor extending the *crédito refaccionario* or *crédito de habilitación o avío* must insure that the proceeds of such financing are in fact used for the precise acquisitions stipulated in the financing agreement, or risk losing the privilege granted to the creditor under the *crédito refaccionario* or *crédito de habilitación o avío* under articles 322 and 324 of the LGTOC.¹⁶⁶

Registration of the *crédito refaccionario* or *crédito de habilitación o avío* agreement "perfects" the security interest, and protects the creditor from claims of third parties that arise subsequent to the registration of the credit.¹⁶⁷ The holder of the security interest is further protected by the provision allowing the holder of such credit at any time to appoint an intervenor who will ensure compliance with the provisions of the credit contract, and whose salary and expenses must be paid by the debtor.¹⁶⁸

(i) *El Crédito de Habilitación o Avío* (The Financing Credit). The *crédito de habilitación o avío* is available for financing the direct and immediate production costs of a business that is already in or that is prepared to commence production.¹⁶⁹ The *crédito de habilitación o avío* attaches to the raw materials and equipment acquired with the proceeds of the credit, as well as to the fruits and products resulting from such credit, whether future or pending.¹⁷⁰

(ii) *El Crédito Refaccionario* (The Equipment and Operating Credit). Proceeds of the *crédito refaccionario* may be used for: the acquisition of tools, instruments, farming implements, fertilizer, cattle or breeding stock; the development of farms and the raising of crops, whether seasonal or permanent; the opening or developing land for farming; the purchase or installation of machinery and equipment and the construction necessary for the debtor's business.¹⁷¹ The credit agreement may also allow for the use of loan proceeds to pay for operating expenses, acquisition costs of real and personal property and taxes incurred with respect to the property, provided that such debts were incurred in the year preceding the date of the credit agreement.¹⁷² The *crédito refaccionario* may be secured,

163. L.G.T.O.C., *supra* note 10, arts. 321-334; Garro, *supra* note 3, at 186.

164. L.G.T.O.C., *supra* note 10, art. 324.

165. L.G.T.O.C., *supra* note 10, art. 322; Garro, *supra* note 3, at 196.

166. CERVANTES, *supra* note 134, at 281; L.G.T.O.C., *supra* note 10, art. 327; Garro, *supra* note 3, at 186.

167. L.G.T.O.C., *supra* note 10, art. 326.

168. *Id.* art. 327.

169. CERVANTES, *supra* note 134, at 281.

170. *Id.*; L.G.T.O.C., *supra* note 10, art. 322.

171. CERVANTES, *supra* note 134, at 282; L.G.T.O.C., *supra* note 10, art. 323.

172. CERVANTES, *supra* note 134, at 282; L.G.T.O.C., *supra* note 10, art. 323.

simultaneously and separately, with real property, improvements, fixtures, machinery and equipment, and in general, all that is acquired or improved by the use of the proceeds of the *crédito refaccionario*, and the fruits and products of the enterprise, whether future, pending, or already obtained by the debtor.¹⁷³

(iii) Similarities/Differences between the *Crédito de Habilitación o Avío* and the *Crédito Refaccionario*. Both credits have the fundamental purpose of funding and encouraging new production and development;¹⁷⁴ and both the *crédito de habilitación o avío* and the *crédito refaccionario* are "generally extended through the opening of a credit line against which the debtor may draw."¹⁷⁵ The security agreement executed in connection with the *crédito de habilitación o avío* and *crédito refaccionario* must state the duration and purpose of the loan and the use of the funds, and provide a precise description of the collateral.¹⁷⁶ But while the direct application of the *crédito de habilitación o avío* is to immediate production, the application of the *crédito refaccionario* is to prepare an enterprise for production.¹⁷⁷ Two illustrations of the difference are as follows: (1) a manufacturer will require the *crédito refaccionario* for the acquisition and installation of production equipment, and the *crédito de habilitación o avío* for the purchase of raw materials and the payment of wages once such equipment is in place; and (2) the owner of a farm or ranch will use the *crédito refaccionario* for the preparation of land for farming or ranching (that is, clearing fields, erecting stalls, putting in place irrigation), and will take the *crédito de habilitación o avío* to purchase seed and fertilizer.¹⁷⁸

The primary obligation of the borrower under the *crédito refaccionario* and the *crédito de habilitación o avío* is evidenced by one or more promissory notes. The security interest granted by the *crédito refaccionario* and the *crédito de habilitación o avío* is not enforceable against third parties, however, until the security agreement and a notation of the transfer of promissory notes, if any, is properly registered.¹⁷⁹ The primary collateral securing the *crédito refaccionario* is the fixed assets, equipment, and improvements of the debtor, and, secondarily, the fruits of the debtor's business produced by such collateral.¹⁸⁰ The *crédito de habilitación o avío* is secured primarily by the production of the debtor's business, and as between the two, the creditor under the *crédito de habilitación o avío* will take preference.¹⁸¹ Both will have priority over all other creditors, other than mortgagees of the same collateral who are prior in time.¹⁸²

As with the civil pledge, the holder of a mercantile pledge is treated as a bailee, and has certain obligations to the debtor with respect to the pledged collateral.¹⁸³ Once the obligation has matured, or in the event that the value of the pledged goods has deteriorated to less

173. CERVANTES, *supra* note 134, at 282; L.G.T.O.C., *supra* note 10, art. 324.

174. CERVANTES, *supra* note 134, at 282.

175. Garro, *supra* note 3, at 187.

176. L.G.T.O.C., *supra* note 10, art. 326; Garro, *supra* note 3, at 187.

177. CERVANTES, *supra* note 134, at 282.

178. *Id.*

179. Garro, *supra* note 3, at 187.

180. CERVANTES, *supra* note 134, at 282; Garro, *supra* note 3, at 187.

181. CERVANTES, *supra* note 134, at 282; Garro, *supra* note 3, at 187-88.

182. CERVANTES, *supra* note 134, at 282; Garro, *supra* note 3, at 188.

183. L.G.T.O.C., *supra* note 10, art. 334; Gerber, *supra* note 87, at 689.

than 120 percent of the outstanding obligation, the creditor may petition the court to authorize the sale of the pledged collateral.¹⁸⁴ A copy of the petition must be forwarded to the debtor, who may oppose the sale by paying the amount of the debt within three days.¹⁸⁵ In the case of a deterioration in the value of the collateral,¹⁸⁶ the debtor may also oppose the sale by pledging additional collateral or reducing the debt so that the value of existing collateral equals at least 120 percent of the outstanding obligation secured.¹⁸⁷ If the debtor does not oppose a sale in the foregoing manner, the judge shall order the sale of the pledged collateral at the price quoted on the stock exchange for pledged securities, or in the absence of such quotation, at fair market value.¹⁸⁸ The creditor may retain the collateral in satisfaction of the debt if the debtor has consented to such remedy subsequent to the establishment of the pledge.¹⁸⁹

(d) *The Civil Pledge.* As has been previously mentioned, the LGTOC governs the commercial pledge. The rules controlling the pledge governed by the Civil Code can be substantially different from those regulating commercial transactions.¹⁹⁰ There are, however, important reasons for studying the form of pledge governed by the Civil Code. First, arguably, the parties entering into a pledge contract can agree to make the contract subject to the rules of the Civil Code, and thus specifically exclude the application of the commercial rules;¹⁹¹ and second, the rules of the Federal Civil Code are supplemental to the provisions of the commercial law to the extent that such rules do not conflict with the legislative intent of the commercial law.¹⁹²

The Mexican Civil Code defines a pledge as a "property right *in rem* over movable, alienable goods for the purpose of guarantying the performance of an obligation and its priorities in payment."¹⁹³ The Civil Code requires the presence of the following elements in order to constitute a contract of pledge: (1) the existence of a prior obligation, (2) delivery of a movable, alienable object to the creditor,¹⁹⁴ and (3) intent that the object shall serve as security against the debtor's performance of the principal obligation.¹⁹⁵ The Civil Code merely requires that the pledged object be movable and susceptible to alienation,¹⁹⁶ and

184. L.G.T.O.C., *supra* note 10, arts. 340-342; Gerber, *supra* note 87, at 689.

185. L.G.T.O.C., *supra* note 10, art. 341.

186. *Id.* art. 340.

187. *Id.* art. 342.

188. *Id.* art. 341.

189. *Id.* art. 344. This agreement is referred to as the *pacto comisorio*, and while enforceable with respect to the commercial pledge, it is not available to the parties to a mortgage or civil pledge unless the agreement is executed *after* default. See C.C.D.F., *supra* note 13, arts. 2883, 2887.

190. Specifically, in the manner in which the pledge is perfected and in the manner in which pledged property may be realized upon, as can be seen by contrasting article 334 of the L.G.T.O.C. with articles 2859 and 2869 of the C.C.D.F., and articles 341 and 342 of the L.G.T.O.C. with article 2884 of the C.C.D.F.

191. Cod. Com., *supra* note 14, art. 78.

192. *Id.* arts. 2, 78; L.G.T.O.C., *supra* note 10, art. 2.

193. C.C.D.F., *supra* note 13, art. 2856; Gerber, *supra* note 87, at 681-82.

194. C.C.D.F., *supra* note 13, art. 2858.

195. Gerber, *supra* note 87, at 682.

196. C.C.D.F., *supra* note 13, art. 2856; Gerber, *supra* note 87, at 682.

therefore, "nearly any kind of movable, alienable property may constitute the pledge res, including intangible property, tangible goods and obligations to give something or to perform certain acts."¹⁹⁷ The requirement that pledged goods be alienable generally excludes professional licenses, support rights, and certain pension benefits that are considered "highly personal in nature and nontransferable as a matter of public policy."¹⁹⁸ Pursuant to the Civil Code, the pledge is evidenced by a written pledge agreement¹⁹⁹ and perfected by delivery of the pledged property to the pledgee, whether by actual or constructive delivery.²⁰⁰ Where these two basic requirements of a pledge are satisfied, the creditor will have sufficient rights to bind the debtor and to seek remedies against him in the pledged collateral. In the event the debtor defaults on his payments, the creditor may demand and the judge shall order the sale of the pledged collateral at public auction.²⁰¹ If collateral cannot be sold at public auction, it is given to the creditor for two-thirds of the legally required minimum bid.²⁰² The debtor may agree after default that the creditor may retain the collateral in satisfaction of all or a portion of the debt²⁰³ or that the pledged item may be sold extrajudicially.²⁰⁴ The debtor may redeem the collateral and rescind the transfer of the collateral to the creditor, or as a result of an extrajudicial sale, if the debtor satisfies the debt within twenty-four hours following such transfer.²⁰⁵ The indebtedness must be reduced by any proceeds earned from the collateral and received by the creditor while pledged, since these proceeds belong to the debtor.²⁰⁶ The pledgee may bring suit against the debtor to collect any deficiency remaining after the disposition of the collateral.²⁰⁷

Where the pledged collateral is lost or deteriorates without the creditor's fault,²⁰⁸ the creditor has the right to demand from the debtor additional collateral or immediate payment of the debt, even though the debt has not matured.²⁰⁹ The creditor is not required to accept replacement collateral or a security bond, and may, in its discretion, rescind the contract entirely.²¹⁰ Any loss or deterioration of the collateral caused by the creditor's lack of care will be at the creditor's expense.²¹¹ Where the creditor fails to exercise care, the debtor

197. RODRIGUEZ, *supra* note 107, at 235; Gerber, *supra* note 87, at 682.

198. Gerber, *supra* note 87, at 683.

199. C.C.D.F., *supra* note 13, art. 2860.

200. *Id.* art. 2858.

201. *Id.* art. 2881.

202. *Id.* art. 2882.

203. *Id.* art. 2883. This provision should be distinguished from the *pacto comisorio*, see discussion *supra* note 189, since the creditor must pay for the collateral to keep it and since the price determination occurs only after default.

204. *Id.* art. 2884.

205. *Id.* art. 2885.

206. *Id.* art. 2880.

207. *Id.* art. 2886.

208. The creditor is required "[t]o preserve the pledged article as if it were his own. . ." *Id.* art. 2876(I). If the creditor meets this standard of care, he will not be liable for loss or damage to the collateral. *Id.* arts. 2877-2878.

209. *Id.* art. 2873(IV).

210. *Id.* art. 2875.

211. *Id.* art. 2876(I).

may, if the contract so stipulates, demand that the collateral be deposited with a third-party bailee or that the creditor "give security to return it in the condition in which he received it."²¹² Thus, upon the debtor's demand, the creditor may not merely restore the collateral but must provide the debtor with assurance that the collateral will be restored. The creditor may tender cash to the debtor, pledge an object to the debtor as security, or deposit cash or other collateral with a third party.

2. Conditional Sale and Title Retention Contracts

The Civil Code, as supplemented by the Code of Commerce, provides for both conditional sale and title retention contracts covering identifiable movable goods.²¹³ While the Civil Code requires an express recision or retention of title clause in the contract, the commercial installment contract automatically includes the right of recision by either party upon the occurrence of an event of default.²¹⁴ The creditor must register the contract of sale with the public registry in order to perfect the security interest retained in the conditional sale contract.²¹⁵ A seller may take advantage of the executory judicial proceeding provided by the Code of Commerce in an action against a defaulting buyer.²¹⁶ If the seller obtains a judicial order to repossess the goods, the seller must return all payments received from the buyer, less (1) an amount equal to the depreciation of the goods while in possession of the buyer, and (2) the amount of fair rental during the time that the goods were in the debtor's possession.²¹⁷

3. Assignments²¹⁸

Under the Civil Code, an assignment is valid as between the parties when a creditor transfers its rights against a debtor to a third party.²¹⁹ Any right can be assigned unless (i) the assignment is prohibited by law, (ii) there is an express agreement not to make an assignment of such right, (iii) or the nature of the right does not permit its assignment.²²⁰ The debtor can not allege, as against the assignee, that the right was not assignable by agreement, unless the prohibition against assignment is contained in the agreement creating the right assigned.²²¹ The consent of the debtor to an assignment is not required,²²² but in the absence of notification of the assignment from the assignee, the assignee will not be deemed

212. *Id.* art. 2877.

213. *Id.* arts. 2310-2315; Cod. Com., *supra* note 14, arts. 371, 372, 376.

214. C.C.D.F., *supra* note 13, arts. 2310, 2312; Cod. Com., *supra* note 14, art. 376; Munger, *supra* note 124, at 779.

215. C.C.D.F., *supra* note 13, arts. 2310(II), 2312.

216. Cod. Com., *supra* note 14, arts. 1391-1414; Garro, *supra* note 3, at 192; Munger, *supra* note 124, at 779.

217. Garro, *supra* note 3, at 192, n. 125.

218. Specifically excluded from this discussion are factoring operations as regulated by the L.G.O.A.A.C., *supra* note 89.

219. C.C.D.F., *supra* note 13, art. 2029.

220. *Id.* art. 2030.

221. *Id.*

222. *Id.* art. 2030.

to have title to the assigned rights, and the debtor may discharge its obligation by paying the original creditor.²²³ The assignment of a credit includes all the rights related and incidental thereto, such as a bond, mortgage, pledge or priority, except those that are inseparable from and personal to the assignee.²²⁴ Accrued interest is presumed to be assigned with a credit obligation.²²⁵

Commercial credits that are not to bearer or endorsable are transferred by assignment.²²⁶ Unless otherwise provided for, the assignor of a credit only warrants the legitimacy of the credit assigned,²²⁷ and not the solvency of the underlying account debtor.²²⁸

Assignment of commercial credits are enforceable against the debtor from the time it is notified of the assignment before two witnesses.²²⁹ The assignment of credit instruments that are not to order or bearer is effective against third parties only from the time when its date is considered certain (*fecha cierta*).²³⁰ Such date certain is determined as follows: (1) if its object is a credit that must be recorded, from the date of its recording in the public property registry; (2) if made in a public instrument (drawn and executed by a notary), from the date of the execution thereof; and (3) in the case of a private document, from the day it is filed or recorded in a public registry, from the death of any of those who signed it, or from the date when it is delivered to a public official by reason of his office.²³¹

Note, however, that with respect to the assignment of credit rights to a Mexican factoring company, the assignment is effective as against third parties from the date of notification of the debtor, without the necessity of either registering the assignment or execution of the document before a notary public.²³² It should also be noted that the notification of account debtors by a factor may be carried out in a number of ways not otherwise available to non-factor assignees, including notification via fax, registered mail, or by the placing of a stamp or legend on the invoice representing such account.²³³

E. THE GUARANTY

1. Personal Guaranties

One of the simplest credit enhancements available under Mexican law is the guaranty of a debtor's obligation by a third party. "Given the variety and difficulty of other security mechanisms, the guaranty is much favored in Mexico, and guarantors who hold real property are preferred."²³⁴ The guaranty takes two forms in Mexico: The *fianza* or the *aval*, with

223. *Id.* art. 2036; Garro, *supra* note 3, at 197; Bass, *supra* note 105, at 104.

224. C.C.D.F., *supra* note 13, art. 2030.

225. *Id.*

226. Cod. Com., *supra* note 14, art. 389.

227. *Id.* art. 391; C.C.D.F., *supra* note 13, art. 2043.

228. C.C.D.F., *supra* note 13, art. 2043.

229. Cod. Com., *supra* note 14, art. 390.

230. C.C.D.F., *supra* note 13, art. 2034; Garro, *supra* note 3, at 197-98; Bass, *supra* note 105, at 104.

231. C.C.D.F., *supra* note 13, art. 2034; Garro, *supra* note 3, at 197-98; Bass, *supra* note 105, at 104.

232. L.G.O.A.A.C., *supra* note 7, art. 45-I.

233. *Id.* art. 45-K.

234. Barragán, *supra* note 65, § 37.02.

the *fianza* taking the form of either a contractual guaranty or a bond issued by government regulated commercial guaranty companies.

The *fianza*, like the guaranty in use in the United States, is a contract between the creditor and the guarantor, whereby the guarantor obligates itself to pay the debts of the principal debtor upon the occurrence of a default in payment or performance by the principal debtor.²³⁵ The *fianza* may guaranty future indebtedness of an undetermined amount.²³⁶

The *aval* differs from the *fianza* in the following aspects. First, the *aval* guarantees the payment of a specific obligation evidenced by a negotiable instrument,²³⁷ and as such, the guaranty obligation appears on the face of the instrument it guarantees (much as a surety or accommodation maker under the Uniform Commercial Code).²³⁸ The *fianza*, on the other hand, as noted above, is a consensual contract between the guarantor and the creditor evidenced by a separate document.²³⁹ Second, the *aval*, unlike the *fianza*, cannot, by its nature, function as a continuing guarantee against future obligations of the principal debtor.²⁴⁰ The *avalista* may guaranty all or a fraction of the debt evidenced by the instrument, but unless a lesser amount is expressly stated, the *avalista* is deemed to guarantee the entire amount of the instrument.²⁴¹ Where more than one party endorses an instrument in the capacity of an *avalista*, the relationship between the various *avalistas* and the obligations of each will depend on the obligation that each assumes.²⁴² Two or more *avalistas* may agree to pay only a portion of the obligation, or alternatively, they may sign as "co-*avalistas*," in which case they will be jointly and severally liable for the entire obligation, with rights of contribution against each other.²⁴³

In addition, the *aval* does not follow the principal debtor's obligation as the *fianza* does. The *avalista* stands independently liable for the guaranteed obligation,²⁴⁴ and such liability continues even if the principal debtor's liability is extinguished as the result of some defect.²⁴⁵ The *aval* not only grants the creditor substantive rights against the *avalista*, but provides for enforcement of the creditor's claim through special summary proceedings provided by the Code of Commerce²⁴⁶ including prejudgment attachment of the *avalista's* assets in the aid of execution.²⁴⁷

Suit on a *fianza* is more restricted. It is subject to a series of defenses granted to the *fiancista* under the Civil Code such as all defenses of the debtor (other than personal

235. C.C.D.F., *supra* note 13, arts. 2794, 2800; Barragán, *supra* note 65, § 37.02.

236. C.C.D.F., *supra* note 13, art. 2798.

237. L.G.T.O.C., *supra* note 10, art. 1009.

238. *Id.* art. 111; RODRIGUEZ, *supra* note 107, at 321-22.

239. RODRIGUEZ, *supra* note 107, at 244.

240. *Id.* at 321; Barragán, *supra* note 65, § 37.02.

241. RODRIGUEZ, *supra* note 107, at 323.

242. *Id.* at 324.

243. *Id.*

244. L.G.T.O.C., *supra* note 10, arts. 114, 154.

245. *Id.* art. 114.

246. Cod. Com., *supra* note 14, arts. 1391-1414.

247. *Id.* arts. 1392-1396.

defenses),²⁴⁸ prior demand,²⁴⁹ and attempt to collect against the property of the principal debtor,²⁵⁰ and a right to join any other guarantors for contribution.²⁵¹

2. Commercial Bonds

Bonds are widely used in Mexico, issued by bonding companies regulated by the Federal Law of Bonding Institutions (*Ley Federal de Instituciones de Fianza*).²⁵² Bonding Companies issue a wide variety of commercial guaranties, including (i) performance bonds, (ii) advance payment bonds, (iii) bid bonds, (iv) subcontractor bonds, and (v) warranties against latent defects.²⁵³ Mexican companies for whose account commercial bonds are issued are generally required to secure such obligations by pledging collateral in favor of the issuer of such bonds,²⁵⁴ in the form of a mortgage, pledge or guaranty trust.²⁵⁵ As a regulated financial institution, bonding companies have the right to non-judicial foreclosure in realizing upon such collateral.²⁵⁶

IV. Creditors Rights

A. COLLECTION ACTIONS AND FORECLOSURE

1. Repossession

The Mexican Constitution provides that every person has the right to the expeditious administration of justice by courts of law, rendering justice in such places and under such terms as established by law, and issuing their resolutions in a prompt, complete, and impartial manner.²⁵⁷ As a result, aside from certain statutory rights to dispose of collateral extra-judicially given to financial institutions, such as commercial warehouses and bonding companies that have possession of collateral, Mexico has no procedures for self-help remedies.

2. Non-judicial Foreclosure

The right of the pledgor to sell goods extra-judicially is provided, by statute, to certain types of regulated institutions.²⁵⁸

(a) *Public Auction*. Unless expressly provided for by law to the contrary, the foreclosure sale of collateral must be at public auction in accordance with the provisions of the applica-

248. C.C.D.F., *supra* note 13, art. 2812.

249. *Id.* art. 2814.

250. *Id.* arts. 2814-2822.

251. *Id.* art. 2827.

252. [L.F.I.F.] D.O. (Dec. 29, 1950).

253. Nelson, *The U.S. Contractor in Mexico*, Newsletter of the Construction Law Section, State Bar of Texas, p. 9 (1995).

254. *Id.*

255. L.F.I.F., *supra* note 252, art. 24.

256. *Id.* arts. 123-25.

257. CONSTITUCIÓN POLÍTICA DE LOS ESTADOS UNIDOS MEXICANOS [Constitution] [CONST.] art. 16 (Mexico).

258. See e.g., L.I.C., *supra* note 16, art. 69; L.G.O.A.A.C., *supra* note 7, arts. 22, 46.

ble code of civil procedure.²⁵⁹ The foreclosure sale of personal property at public auction is conducted either through a public broker (*corredor público*) or a commercial enterprise that deals in like goods.²⁶⁰ The value of the goods to be sold is fixed by an expert or by the agreement of the parties, and such valuation will serve as the basis for the minimum bid.²⁶¹ Notice of the sale is given by publication.²⁶² Prior to the commencement of the auction, the debtor may redeem the goods by paying all outstanding principal and interest, and posting cash in the amount of any costs incurred in preparing for the auction.²⁶³

(b) *Private Sale.* Article 83 of the Law of Credit Institutions allows for the establishment of a guaranty trust with the power to dispose of collateral extra-judicially. With the exception of trusts there is no express right under Mexican law permitting the private sale of repossessed collateral without the prior consent of the debtor.

(c) *Strict Foreclosure.* Mexican law also allows for the retention by the pledgor of pledged goods in satisfaction of a debt, with the express agreement of the pledgor; provided that such agreement is entered into subsequent to the execution of the pledge agreement.²⁶⁴

3. Judicial Foreclosure

Court proceedings in Mexico are either ordinary or summary in nature.²⁶⁵ Transactions allowing for summary proceedings are preferred for at least two reasons. First, a judgment from summary proceedings can be obtained within a relatively short period of time. A collection action, for example, may be reasonably expected to be concluded within one year, while ordinary proceedings for collection "may be reasonably expected to take two years, even if few, if any, defenses are available to the defendant."²⁶⁶ Second, while prejudgment attachment of a defendant's assets to assure execution is a common strategy, in ordinary proceedings the evidentiary burden placed upon the plaintiff in order to obtain prejudgment attachment is generally higher than that required for summary proceedings.²⁶⁷

Whether summary proceedings are available in a specific transaction will depend initially on the underlying documentation evidencing the obligation.²⁶⁸ Generally, promissory notes and drafts, public deeds before notaries, and documents acknowledged as legitimate by the parties before a notary public or court may be submitted for enforcement through summary proceedings.²⁶⁹

As a result, satisfaction of claims with respect to most secured transactions can be claimed by means of a summary commercial proceeding (*juicio ejecutivo mercantil*) as regu-

259. See e.g., Código de Procedimientos Civiles para el Distrito Federal [Code of Civil Procedure of the Federal District] [C.P.C.] D.O. (Sept. 1-21, 1932), arts. 564-65.

260. *Id.* art. 598, I.

261. *Id.* arts. 569, 598, I.

262. *Id.* art. 570.

263. *Id.* art. 571.

264. L.G.T.O.C., *supra* note 10, art. 344. See also C.C.D.F., *supra* note 13, art. 2883.

265. Sergio A. Leiseca & Thomas W. Studwell, *Latin American Accounts Receivable: To Sue for Collection or to Refinance?*, 39 BUS. LAW. 495, 501 (1984).

266. *Id.*

267. *Id.*

268. *Id.*

269. *Id.* See also Cod. Com., *supra* note 14, art. 1391.

lated by articles 1391 to 1414 of the Code of Commerce. The procedural provisions of the Code of Commerce are supplemented by the rules of the Code of Civil Procedure of the state where the litigation occurs.²⁷⁰ While the Codes of Civil Procedure of every state are supplemental to the Code of Commerce, they are so only to the extent that the Code of Commerce has no specific provision on point and that such rules do not conflict with expressed legislative intent to suppress certain procedural or evidentiary rules.²⁷¹

The summary commercial proceeding, in the context of the secured transactions referred to in this article, can be described as follows:

- (1) To begin an executive proceeding (*juicio ejecutivo*) the plaintiff's original petition must be supported by an executive document (*titulo ejecutivo*).²⁷² The Supreme Court, in several judicial precedents (some of which are mandatory precedents), has held that those documents that statutorily qualify as executive documents constitute pre-made evidence of the cause of action.²⁷³ Executive documents presented in support of a plaintiff's cause of action are considered conclusive proof, even if offered without notice to the adverse party, subject to the latter's right to claim such documents are false and request a comparison with the original document of record.²⁷⁴
- (2) The Code of Commerce qualifies as executive documents the following:²⁷⁵ (a) those final judgments that are considered *res judicata*; (b) final arbitral awards; (c) public documents; (d) judicial confession of the debtor with respect to all causes of action in the plaintiff's original petition; (e) negotiable instruments such as bills of exchange, receipts and promissory notes; (f) insurance policies; (g) the decision of experts appointed by insurance companies to conduct appraisals; and (h) invoices, revolving accounts, and any other commercial contracts signed and judicially acknowledged by the defendant.
- (3) Once the plaintiff has filed a petition supported by an executive document, the court must issue a formal order ordering the seizure of enough of the debtor's property to ensure that the debt owed the plaintiff and the plaintiff's legal expenses will be paid. The plaintiff is required to appoint a depository for such property.²⁷⁶
- (4) The preferable order to seize such property is as follows:²⁷⁷ (a) merchandise and inventory; (b) easily collectible accounts receivable; (c) other personalty; (d) real estate; and (e) shares of stock and other rights of the defendant.

270. Cod. Com., *supra* note 14, art. 1054.

271. Volume XXV, Fifth Epoch, pt. 1, at 67 (1929); Volume XXV, Fifth Epoch, pt. 1, at 795 (1929); Volume XXV, Fifth Epoch, pt. 1, at 2328 (1929); Volume XXVI, Fifth Epoch, pt. 2, at 1811 (1929) (this is a mandatory precedent).

272. Cod. Com., *supra* note 14, art. 1391.

273. Volume XXXII, Fifth Epoch, pt. 1, at 1150 (1931); Volume XXXIX, Fifth Epoch, pt. 1, at 922 (1933); Volume XL, Fifth Epoch, pt. 3, at 2484 (1934); Volume XLI, Fifth Epoch, pt. 2, at 1321 (1934); Volume XLI, Fifth Epoch, pt. 2, at 1669 (1934) (this is a mandatory precedent).

274. Cod. Com., *supra* note 14, art. 1292.

275. *Id.* art. 1391.

276. *Id.* art. 1392.

277. *Id.* art. 1395.

After levy of attachment, the court will notify the debtor that it must either answer the plaintiff's petition with the appropriate legal defense within five days, or produce proof of payment of all amounts required to satisfy the lawsuit, plus costs.²⁷⁸ If the defendant fails to either pay the debt or answer the petition within such five-day period, at the request of the plaintiff, the court shall issue a judgment ordering the sale of seized property and the payment of the debt with the proceeds of such sale.²⁷⁹ If the debtor answers the plaintiff's petition, the debtor must, along with its answer, file all documents supporting its defense, and the court will open a period of ten to fifteen days to introduce such evidence.²⁸⁰ Once the period to introduce evidence has elapsed, the court shall publish all evidence²⁸¹ and call the parties to an oral hearing to hear the arguments of both parties.²⁸² If the judgment is favorable to the plaintiff, the court shall order the sale of the seized property after such property has been appraised by experts.²⁸³ The sale of seized property shall be made at public auction to the highest bidder.²⁸⁴ If the property is not sold, the plaintiff can request that the property be assigned to the plaintiff at the minimum bid price established for the last auction.²⁸⁵ In the event that the court finds that the plaintiff is not entitled to an executive proceeding, the rights of the plaintiff are, nonetheless, maintained to be exercised in accordance with proper, non-summary proceedings.²⁸⁶

B. COMMERCIAL BANKRUPTCY PROCEEDINGS IN MEXICO

Insolvency proceedings of legal and natural persons engaged in business are governed by the Federal Law of Bankruptcy and Suspension of Payments (*Ley de Quiebras y Suspension de Pagos*) (LQSP).²⁸⁷

According to the LQSP, bankruptcies are classified as either (1) fortuitous bankruptcies; (2) culpable bankruptcies; or (3) fraudulent bankruptcies.²⁸⁸ Articles 92 to 114 of the LQSP define these three types of bankruptcies. A bankruptcy is considered fortuitous when, although the company was properly managed, the company was the victim of unforeseen circumstances that reduced its capital to the point that it could no longer meet its financial obligations.²⁸⁹ Culpable bankruptcies are declared as a result of acts inconsistent with prudent business practices.²⁹⁰ A bankruptcy will be presumed *prima facie* fraudulent if the

278. *Id.* art. 1396.

279. *Id.* art. 1404.

280. *Id.* arts. 1400 (for attachment proceedings) and 1405 (for suits with respect to commercial paper).

281. *Id.* art. 1406.

282. *Id.* art. 1400.

283. *Id.* art. 1410.

284. *Id.* art. 1411.

285. *Id.* art. 1412.

286. *Id.* art. 1409.

287. L.Q.S.P., *supra* note 50; MULTINATIONAL COMMERCIAL INSOLVENCY, *supra* note 90, at 0-2.

288. L.Q.S.P., *supra* note 50, art. 91; MULTINATIONAL COMMERCIAL INSOLVENCY, *supra* note 90, at 0-17.

289. L.Q.S.P., *supra* note 50, art. 92; MULTINATIONAL COMMERCIAL INSOLVENCY, *supra* note 90, at 0-17.

290. L.Q.S.P., *supra* note 50, art. 93 (art. 95 provides for one to four years imprisonment for culpable bankruptcies, and the article implies that this penalty is mandatory rather than discretionary); MULTINATIONAL COMMERCIAL INSOLVENCY, *supra* note 90, 0-17.

company deceitfully disposes of all or part of its goods before or after the declaration in bankruptcy, commits acts during the pendency of the bankruptcy to increase its liabilities and decrease its assets, fails to keep those books and records required by law or allows their condition to become such that it is impossible to determine the entity's financial position, or favors a creditor who does not have a legal right to preferential treatment.²⁹¹ A person who causes a fraudulent bankruptcy will be subject to a maximum ten-year prison sentence and a maximum fine of 10 percent of his assets.²⁹² The directors, managers, and trustees of a corporation responsible for the fraudulent acts may be subject to these sanctions if the bankrupt is a corporation.²⁹³ If a creditor of the bankrupt conspires with the bankrupt, the creditor will also be subject to criminal sanctions.²⁹⁴

Creditors are divided into the following groups, each receiving its full share before the next group enters into the distribution:²⁹⁵ in their preferential order, the categories are (1) the singularly privileged creditors whose claims are for the funeral expenses of the bankrupt (if the declaration of bankruptcy took place after death), for expenses of the last illness, and for salaries of employees whose services the bankrupt used in the year preceding bankruptcy;²⁹⁶ (2) mortgage and pledge creditors;²⁹⁷ (3) the federal treasury for unpaid federal taxes;²⁹⁸ (4) creditors with special privilege;²⁹⁹ (5) the general unsecured commercial creditors;³⁰⁰ and (6) the general unsecured civil creditors.³⁰¹ Payment of administrative expenses takes priority over all creditors except the singularly privileged creditors.³⁰²

All of the creditors within a category, except for mortgagees, pledgees and specially privileged creditors, share pro rata.³⁰³ The order of payment for mortgage and pledge creditors is determined by the category of each creditor and the creditor's priority within that category based on the date of perfection of the security interest as provided by law.³⁰⁴ Commentators disagree as to whether pledge creditors are ranked in the second class along with mortgagees or in the fourth class along with the special privilege creditors. A review of recent materials written by Mexican practitioners and academicians, however, places the pledge creditor in the same category as the mortgagee, with creditors, such as installment

291. L.Q.S.P., *supra* note 50, arts. 96-98; MULTINATIONAL COMMERCIAL INSOLVENCY, *supra* note 90, at 0-17.

292. L.Q.S.P., *supra* note 50, art. 99.

293. *Id.* art. 101; Richard N. Hansen & John H. Young, *Bankruptcy in Mexico*, 4 TEX. INT'L L.J. (now TEX. INT'L L.J.) 140, 144 (1968).

294. L.Q.S.P., *supra* note 50, art. 110; Hansen & Young, *supra* note 293, at 144.

295. L.Q.S.P., *supra* note 50, art. 261; MULTINATIONAL COMMERCIAL INSOLVENCY, *supra* note 90, at 0-14.

296. L.Q.S.P., *supra* note 50, art. 262; MULTINATIONAL COMMERCIAL INSOLVENCY, *supra* note 90, at 0-14.

297. L.Q.S.P., *supra* note 50, art. 263; MULTINATIONAL COMMERCIAL INSOLVENCY, *supra* note 90, at 0-14.

298. MULTINATIONAL COMMERCIAL INSOLVENCY, *supra* note 90, at 0-14.

299. *Id.* arts. 264-265.

300. *Id.* art. 266.

301. *Id.* art. 276.

302. *Id.* arts. 270-271.

303. *Id.* arts. 263-64.

304. MULTINATIONAL COMMERCIAL INSOLVENCY, *supra* note 90, at 0-14.

sale vendors with statutory rights of recision, and other creditors given special status by the Code of Commerce, occupying the special privilege category.³⁰⁵

1. Parties in the Bankruptcy Proceeding

(a) *The Trustee (sindico)*. The bankruptcy judge is principally responsible for the surveillance and prosecution of the bankrupt and its operations.³⁰⁶ In practice, however, such duties are delegated to a trustee who, as an officer of the court and representative of the State, oversees the liquidation or maintenance of the commercial entity. The trustee ensures the conservation and normal administration of the bankrupt estate, including taking possession of the company, preparation of financial reports, exercising control over money deposits, rendering quarterly performance reports and rendering a general report on the status of the bankruptcy.³⁰⁷ The payment of the trustee's fees are paid from the assets of the estate³⁰⁸ with priority over all other creditors.³⁰⁹

(b) *The Intervenor (interventor)*. Another party in the bankruptcy proceeding is the intervenor who is designated temporarily³¹⁰ at the filing of a bankruptcy petition and thereafter permanently³¹¹ by agreement of the creditors. The intervenor is in charge of representing the interests of the creditors by overseeing the trustee's performance in the administration of the bankruptcy.³¹²

(c) *The Creditors Committee (junta de acreedores)*. Finally, the creditors of the bankrupt collectively vote as to certain matters, such as the acknowledgment of credits, designation of intervenors, approval of payment agreements and the trustee's accounts, and the relations of the trustee with the intervenor. Each creditor has one vote, irrespective of the amount represented by such vote, except in cases so stipulated by law, such as the approval of payment agreements.³¹³

2. Effects of the Declaration of Bankruptcy

(a) *The Bankrupt*. Bankruptcy creates a special legal status for the bankrupt, limiting the exercise of its rights and transferring its property to the estate.³¹⁴ The bankrupt is prevented from carrying out acts of ownership and of administration with respect to estate property.³¹⁵

(b) *The Estate*. The bankrupt is dispossessed of its property for the purpose of forming, with all present and future assets, the bankruptcy estate for the benefit of creditors. Certain properties or rights are excluded from the estate, such as the rights and property of third

305. See, e.g., RODRIGUEZ *supra* note 107, at 391-92. MULTINATIONAL COMMERCIAL INSOLVENCY, *supra* note 90, at 0-14.

306. L.Q.S.P., *supra* note 50, art. 26.

307. *Id.* arts. 46, 48.

308. *Id.* art. 57.

309. *Id.* art. 270.

310. *Id.* art. 59.

311. *Id.* art. 60.

312. *Id.* art. 58.

313. *Id.* art. 79.

314. *Id.* art. 82.

315. *Id.* art. 63.

persons, personal rights inherent to the bankrupt (such as intellectual capacity, artistic qualities, etc.), and property that is exempt by law (such as the family patrimony, alimony, etc.).³¹⁶

(c) *Proceedings on Behalf of the Estate.* Actions brought on behalf of or against the estate are conducted by the trustee, before the competent bankruptcy judge, except for suits where final judgment has been rendered and suits arising from pledge or mortgage credits. They are dealt with in the bankruptcy proceeding only for purposes of ranking and payment.³¹⁷

(d) *Existing Legal Relations.* As of the time of the declaration of bankruptcy, the pending obligations of the bankrupt are considered to have expired.³¹⁸ In addition, the debts of the bankrupt cease to accrue interest as of the declaration of bankruptcy, with exception of mortgage and pledge credits.³¹⁹

(e) *Pending Bilateral Agreements.* The bankruptcy itself is not cause for the termination of bilateral agreements pending performance; provided, however, that they may only be executed by the trustee with the prior approval of the bankruptcy judge, and the right to request the rescission of such agreements is subordinated to the right of the trustee to perform same.³²⁰ In addition, a contractor who is not bankrupt may suspend the performance of such an agreement until such time as the compliance therewith is guaranteed in the bankruptcy proceeding.³²¹

Notwithstanding the foregoing, certain specific agreements exist which are terminated by the mere declaration of bankruptcy, such as deposit agreements, commitments to provide credit, and commission and mandate agreements.³²²

(f) *Effects on Spouses.* In general, the bankruptcy affects the property of the non-bankrupt spouse acquired during the marriage. It is assumed that the bankrupt spouse owns the property of the non-bankrupt spouse which was acquired during the marriage within the five years prior to the declaration of bankruptcy.³²³ This assumption may be rebutted by evidence that such property was acquired as separate property or prior to the marriage.³²⁴ The claims of a spouse against a bankrupt spouse are, save proof to the contrary, assumed to have been paid.³²⁵ In the case of a joint estate of the spouses, all of the properties pertaining to the joint estate are in the bankruptcy estate, and the non-bankrupt spouse may request termination of the joint estate and the separation of his or her corresponding property.³²⁶

(g) *Actions Taken Prior to the Declaration of Bankruptcy; The Suspicious Period.* Every creditor of the bankrupt has an action to annul transactions entered into with a third party to the prejudice of other creditors if such acts are entered into prior to the insolvency of the bankrupt and defraud creditors of the bankrupt, and such third party had knowledge of

316. *Id.* art. 115.

317. *Id.* art. 126.

318. *Id.* art. 128, I.

319. *Id.* art. 128, II.

320. *Id.* art. 139.

321. *Id.*

322. *Id.* art. 141.

323. *Id.* art. 163.

324. *Id.*

325. *Id.* art. 164.

326. *Id.* art. 165.

such fraud.³²⁷ In addition, the bankruptcy judge has the discretion to adjust the date on which the bankrupt is determined to be insolvent from the date of filing of the bankruptcy petition, to the date prior to the filing on which the judge determines the bankrupt to have actually become insolvent.³²⁸ The period from the date on which the judge determines the bankrupt to be insolvent, to the date of the filing of the bankruptcy petition is referred to as the "suspicious period". Generally, the suspicious period does not predate the filing of the bankruptcy petition by more than six months. During the suspicious period, the following transactions are presumed to be acts that defraud creditors and are voidable, unless proof to the contrary is presented:³²⁹

- (1) Acts or transfers made without consideration, or without the giving of equivalent value on the part of the third party receiving the transfer.
- (2) The payment of debts and obligations that are not then due, made by or for the benefit of the debtor, in cash, instruments or stock, or any other method; provided that if the party receiving such payment is required to return same to the estate, it can petition to have its credit reinstated.
- (3) The discount by the debtor of its goods, which is considered as a pre-payment.

In addition, the following transactions will be presumed to have been done to defraud creditors unless the interested party proves its good faith:³³⁰

- (1) The payment of mature obligations made in a species other than as provided for such obligation.
- (2) The granting of liens for debts predating the suspicious period, or for loans made either before or after such period where such loans were not verified by a notary public or witnesses at the time of making such loans.

(h) *Separation From Bankruptcy.* If, at the time bankruptcy is declared, there exists within the bankruptcy estate property not owned by the bankrupt, or to which certain rights are held by third parties, Mexican law provides for an action to separate such property from the estate.³³¹ Without excluding other analogous situations where an action for separation may be brought, Mexican law permits the separation from the bankruptcy estate certain property in the following situations:³³² (i) real property sold to the bankrupt and not paid by it, if the purchase and sale agreement has not been duly registered; (ii) personal property purchased in cash if the bankrupt should have not paid the price in full; (iii) personal or real property subject to a properly registered rescission of title agreement upon the occurrence of a default; (iv) property in possession of the bankrupt in deposit, administration, lease, usufruct, trust, consignment, purchase and sale, commission, transit, delivery or collection; and (v) amounts owed by the bankrupt by reason of sales made for a third party's account. The law also provides that property given in pledge constituted by public instrument, in a policy granted before a public broker, evidenced by pledge bonds issued by

327. *Id.* art. 168.

328. *Id.*

329. *Id.* art. 169.

330. *Id.* art. 170.

331. *Id.* art. 158.

332. *Id.* art. 159.

a general deposit warehouse in favor of a credit institution, may also be separated from the estate.³³³ Although in practice such separation has occurred too infrequently to state with certainty the ease in which such separation may be accomplished.

(i) *Termination of Bankruptcy.* Bankruptcy terminates either because of payment to creditors following liquidation of the estate,³³⁴ only one creditor appeared in the bankruptcy proceeding to make a claim against the estate,³³⁵ the unavailability of sufficient assets of the debtor to pay for even the costs of the bankruptcy proceeding,³³⁶ by the unanimous agreement of the creditors,³³⁷ or by agreement of the creditor's committee.³³⁸

3. Suspension of Payments

Suspension of payments proceedings allow the bankrupt to readjust its finances by means of a payment moratorium and a definitive settlement agreement for the payment of creditors, thus avoiding liquidation and permitting continuation of the business. In order to obtain the benefit of the suspension of payments, certain requirements must be complied with, such as not having been convicted of crimes against property, not having failed to meet obligations assumed in an agreement for suspension of payments, and not having failed to present required documentation.³³⁹ All merchants, before declaring bankruptcy, may request that they be declared in suspension of payments and that a meeting of the creditors be called.³⁴⁰ Under the jurisdiction of the bankruptcy judge, the creditors will be convened in order to seek a consensus on the agreement to avoid bankruptcy filed by the debtor.³⁴¹ Only the preferred or secured creditors are not required to participate in the agreement, and the agreement must be accepted by a majority of creditors who are present and whose claims represent a majority of the total liabilities of the creditors voting.³⁴² When approved by the judge, the composition becomes binding on the bankrupt and on all creditors whose claims antedate the declaration of bankruptcy. During the composition procedure the debtor is required to maintain its property and continue its customary operations under the supervision of an appointed trustee.³⁴³

After the status of suspension of payments has been granted, the court enters a judgment ordering the publication of same for the purposes of informing all third parties and creditors,³⁴⁴ requesting the delivery of financial information and commercial books, and securing the properties of the bankrupt by means of an order to deliver possession of same

333. *Id.* art. 159, VI(d).

334. *Id.* arts. 274-86.

335. *Id.* arts. 289-91.

336. *Id.* arts. 287-88.

337. *Id.* arts. 292-95.

338. *Id.* arts. 296-379.

339. *Id.* art. 396.

340. *Id.* art. 394.

341. *Id.* See also, D. DARROW, P. DARROW, D. DOETSCH, M. JAUREGUI-ROJAS & M. NADER, *RESTRUCTURING STRATEGIES FOR MEXICAN EUROBOND DEBT*, 40 (1995).

342. *RESTRUCTURING*, *supra* note 341, at 41.

343. L.Q.S.P., *supra* note 50, art. 410.

344. *Id.* art. 421.

to the trustee. The petition for the suspension of payments should be accompanied by an agreement for the repayment of creditors.³⁴⁵

The effects of suspension of payments are the following:

- a) So long as the proceeding lasts, no credit that antedates the proceeding may be enforced or paid.³⁴⁶
- b) The statute of limitations are tolled until such time as the agreement is approved or bankruptcy is declared.³⁴⁷
- c) All legal proceedings against the debtor subject to suspension of payments are suspended, except for those with respect to properties not owned by the debtor, and actions for labor debts, alimony and secured debts.³⁴⁸
- d) The debtor may continue in the administration of its properties and continue the current operations of the company under the surveillance of the trustee.³⁴⁹
- e) While acting under the surveillance of the trustee, the judge may authorize additional acts, other than the normal administration of the estate, such as the granting of mortgages, pledges, etc.³⁵⁰
- f) The designation of an intervenor is at the option of creditors, and the judge may not make any temporary or permanent appointment of an intervenor.³⁵¹

The proceeding of suspension of payments concludes with performance of the agreement. During the term set out for the execution and performance of the agreement, the trustee shall continue in office to oversee the conduct of the debtor and the performance of the agreement.³⁵²

C. SIMILARITIES BETWEEN MEXICAN AND U.S. BANKRUPTCY LAW

1. Exclusivity

A debtor's preventative agreement, roughly analogous to a Chapter 11 Plan, is proposed and filed on the first day of suspension of payments proceedings.³⁵³ This typically is followed by several months of negotiations with creditors over what they consider to be acceptable terms for such agreement.³⁵⁴ Under Chapter 11 of the U.S. Bankruptcy Code, the Debtor has the exclusive right to file a Plan for the first 120 days of the reorganization proceeding, subject to extension, leading to frustration among creditors who may have developed their own plan but cannot propose it, or bring it to a vote, so long as the debtor's exclusive period remains in force.³⁵⁵

345. *Id.* art. 398.

346. *Id.* art. 408.

347. *Id.*

348. *Id.* art. 409.

349. *Id.* art. 410.

350. *Id.* art. 411.

351. *Id.* art. 417.

352. *Id.* art. 424.

353. RESTRUCTURING, *supra* note 341, at 44.

354. *Id.*

355. *Id.*

2. Class Voting

Generally, each creditor is entitled to one vote in voting on the preventative agreement, although the LQSP requires qualified majorities by creditor class³⁵⁶ and by dollar amount of claims to approve certain preventative agreements where excessive debt forgiveness³⁵⁷ and/or repayment time is sought.³⁵⁸ In a Chapter 11 Plan of Reorganization, the various types of creditors (secured, subordinated and unsecured), must be divided into separate classes that vote in the Plan by class.³⁵⁹ For a class to be deemed to have accepted a Plan, the votes of two thirds in dollar amount and a majority in number of those voting within a given class must vote in favor of such Plan.³⁶⁰ At least one "impaired" class (i.e., a group of creditors receiving less than a full recovery) must vote to accept the Plan, and creditors who receive a full recovery do not vote and, instead, are deemed to have accepted the Plan.³⁶¹

3. Cram Down

If a preventative agreement receives a majority vote of the creditors in a suspension of payments proceeding, then such agreement is binding on all creditors.³⁶² Creditors who voted against the agreement, even if they are a large minority block, are forced to accept the agreement.³⁶³ Chapter 11 takes a somewhat different approach, providing that a Plan can be approved even if all creditors in a given class vote against it.³⁶⁴ In order for the Plan to be "crammed down" on these dissident creditors, however, it must be shown that (i) no one junior to the dissident creditors is receiving any consideration, and (ii) the dissident creditors would fare no worse in a liquidation proceeding.³⁶⁵

4. Equitable Subordination

Under Chapter 11, the claims of a given creditor or creditor group can be "subordinated" by the Bankruptcy Court to a more junior ranking, thus diminishing their recovery under the Plan.³⁶⁶ Under Mexican Bankruptcy Law, there is no proceeding analogous to equitable subordination.³⁶⁷

V. Conclusion

While the NAFTA has opened the Mexican financial services industry to U.S. and Canadian firms, entry into this sector of the Mexican economy by means of cross-border

356. See, e.g. L.Q.S.P., *supra* note 50, art. 304.

357. *Id.* arts. 317, 319.

358. *Id.* arts. 318, 320.

359. RESTRUCTURING, *supra* note 341, at 45.

360. *Id.*

361. *Id.*

362. *Id.*

363. *Id.*

364. *Id.*

365. *Id.*

366. *Id.*

367. *Id.*

lending activity continues to present such firms with many challenges in structuring sophisticated secured credit transactions similar to those put together in the United States and Canada. In the absence of significant law reform in the area of secured transaction, the most attractive vehicle for structuring such transactions in Mexico appears to be via Mexico's law regulating financial groups³⁶⁸ which permits affiliated financial institutions, such as banks, factoring companies, financial leasing companies and warehouses, to interact and operate together under the umbrella of a single financial group holding company.³⁶⁹ Such a financial group holding company is permitted by law to operate its various entities from shared locations and under the same or similar names.³⁷⁰ Operating within the existing framework of the Mexican law of secured transactions, such affiliated financial groups could participate in more sophisticated credit transactions, offering previously unrelated services to their clients under a single name and from a single location, resulting in greater access to credit and coordinating and streamlining the securitization devices now available to the secured lender under current Mexican law.³⁷¹

As an example, a prospective borrower should be able, in seeking credit from a well organized financial group, to obtain a credit facility secured by its personal property by dealing with such a financial group at a centralized location, even though the pledge or lien on the different types of collateral securing the credit (i.e., account receivable, inventory and equipment) will be in favor of a factoring company, commercial warehouse, bank, financial leasing company and/or limited scope financial institution. Such an arrangement should promote the economies of scale necessary to lower the transaction costs that would be incurred in dealing with each such entity separately, in that a well run financial group should be able to coordinate the monitoring of such a credit from a single "back room" operation.

Unfortunately, due to the current crises in the Mexican banking sector, it is unlikely in the near future that Mexican financial groups will have the resources to either make such loans or develop such structures. The few foreign institutions which have or are in the process of establishing financial groups, with both the capital, and in many cases the internal infrastructure and experience to administer asset-based type lending transaction, may have an opportunity to gain market share and provide needed capital to Mexico's struggling middle market companies.

In addition, cross-border opportunities exist for lenders from NAFTA member countries to fully utilize existing Mexican secured lending law to make loans to such companies. And, with the use of little used structures, such as a Mexican factoring company as a *servicer* of accounts receivable transactions (thereby taking advantage of the relatively streamlined perfection procedures given licensed factoring companies), and field warehousing (which, if utilized with a Mexican warehousing company, not only provides for a way to perfect a pledge on inventory, but also a means to foreclose on same non-judicially) to secure such loans with collateral not traditionally considered by Mexican lenders; provided that such foreign lenders are willing to export to Mexico and educate Mexican borrowers in the methods of collateral management and control used in the U.S. and Canada.

368. LEY PARA REGULAR LAS AGRUPACIONES FINANCIERAS [Law to Regulate Financial Groups], D.O. (Jul. 18, 1990, as amended).

369. *Id.*

370. *Id.* art. 8.

371. *Id.*